No. 16859

United States
Court of Appeals
for the Ninth Circuit

HAWAIIAN TRUST COMPANY, LIMITED, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the District of Hawaii

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-10-60

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

For the Plaintiff, Hawaiian Trust Company, Limited:

ANDERSON, WRENN & JENKS, by
MARSHALL M. GOODSILL, ESQ.,
Bank of Hawaii Building,
Honolulu, Hawaii.

For the Defendant, United States of America:

LOUIS B. BLISSARD, ESQ.,
United States Attorney,
Federal Building,
Honolulu, Hawaii.

United States District Court for the
District of Hawaii

Civil Action No. 1619

HAWAIIAN TRUST COMPANY, LIMITED, a Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Hawaiian Trust Company, Limited, a Hawaii corporation, Trustee for the creditors and stockholders of Pacific Refiners, Limited, a dissolved Hawaii corporation, brings this suit against the United States of America and claims and alleges:

I.

This is a civil action by a corporation incorporated under the laws of the Territory of Hawaii and doing business in the Territory of Hawaii against the United States for recovery of Internal Revenue taxes and interest erroneously and illegally assessed and collected, of which this court has jurisdiction, regardless of the sum involved, under Title 28, U. S. Code, Sections 1340 and 1346.

II.

Plaintiff has complied with the requirements of

Sections 6532(a) and 7422(a) of the Internal Revenue Code of 1954 (and the predecessor sections of the 1939 Code) regarding suits for recovery of any Internal Revenue tax, penalty or other sum, as hereafter more fully appears.

III.

Plaintiff's claim is for the recovery of $109,692.18 in principal amount of income taxes illegally and erroneously assessed and collected from plaintiff for the taxable years 1953 and 1955, plus $15,055.76 interest paid thereon, or a total of $124,747.94. In addition, plaintiff is entitled to interest on the entire amount of principal and interest paid, as provided by law. The amounts of the overassessments and overpayments for each year are as follows:

Year	Principal	Interest	Total
1953	$ 58,472.39	$11,301.99	$ 69,774.38
1955	51,219.79	3,753.77	54,973.56
	$109,692.18	$15,055.76	$124,747.94

IV.

The facts upon which plaintiff's claim for the year 1953 is based are as follows:

(a) Pacific Refiners, Limited (hereinafter called Refiners) was organized as a corporation under the laws of the Territory of Hawaii on May 31, 1949. It was dissolved on November 19, 1956, and Hawaiian Trust Company, Limited, was appointed trustee for the creditors and stockholders. Refiners' taxable year was the calendar year.

(b) Refiners' principal business was the manufacture and sale of petroleum products and the distribution of butane (a form of liquefied petroleum gas) in the Territory of Hawaii. Refiners entered into an oil and butane contract with Standard Oil of California in August, 1949, for a period of ten years for the purchase of petroleum oil and butane. The butane was blended by Standard Oil Company of California into heavy gas oil and shipped to Refiners in Honolulu. Refiners at its refinery in Honolulu separated the butane from the gas oil. The butane thus obtained was liquefied and stored by Refiners in pressure tanks, ready for distribution and sale. The butane-free gas oil was then passed through a further process which removed diesel oil and similar fractions contained in the original oil, leaving asphalt. The gas oil was then sold to Honolulu Gas Company, Limited, for its use in the manufacture of gas. Under this contract with Standard Oil Company, Refiners was required to purchase a substantial minimum amount of heavy gas oil blended with butane. Refiners was not a public utility, and its buatne business was not subject to regulation by the Territorial Public Utilities Commission.

(c) Hilo Gas Company, Limited, was organized in 1927 as a public utility company to manufacture gas from oil and distribute it through gas mains in the city of Hilo. It had encountered financial difficulties, and in the spring of 1950 entered into negotiations with Refiners. The proposition was made that Hilo Gas Company cease the manufacture of gas and buy butane from Refiners, which the Hilo Gas Company would then distribute through its gas mains in the city of Hilo as a public utility. This would save manufacturing cost and reduce gas rates to a point where they might be competitive with electric rates. The negotiations failed, but in September, 1950, the two principal stockholders of Hilo Gas Company offered to sell their stock. Refiners was interested, because the acquisition of the Hilo Gas Company would provide an assured outlet for butane on the island of Hawaii. In view of Refiners' commitment to Standard Oil Company to purchase minimum amounts of butane, and in view of the fact that Refiners' new refinery was to be completed in December of 1950, it became imperative to Refiners to find outlets for its butane production as quickly as possible in order to comply with the terms of its contract with Standard Oil. Therefore, on October 3, 1950, an option was obtained by Refiners from Mr. Lyman (president of the Hilo Gas) granting to Refiners a seven-day option to purchase his shares (subject to the condition that the purchaser obtain options to purchase not less than 75% of each of the outstanding classes of stock of Hilo Gas Company). On the same date Refiners obtained a similar option from Mr. Hutchinson, the other principal stockholder.

(d) On October 5, 1950, the Board of Directors of Refiners authorized the purchase of the Hilo Gas Compnay stock. Hilo Gas Company had two classes of capital stock outstanding—8% first preferred and 7% second preferred. Both classes had voting rights.

(e) The stock of Messrs. Lyman and Hutchinson was sold to Refiners on October 6, 1950. At about the same time Refiners also purchased the largest blocks of stock held by other stockholders. On October 21, 1950, a letter was sent to the remaining stockholders of Hilo Gas Company offering to purchase their shares at the same price, and pursuant to this offer, Refiners purchased before October 25 most of the outstanding shares of both classes held by minority stockholders. Prior to October 25, 1950, Refiners had ecquired 95% or more of the outstanding capital stock of Hilo Gas Company. On October 25, 1950, the general manager reported to the directors of Refiners that 96% of the stock of Hilo Gas Company had been acquired.

(f) On October 20, 1950, Hilo Gas Company, Limited, filed a petition with the Public Utilties Commission for authority to sell its utility assets to Honolulu Gas Company, Limited. A hearing on this application was held on October 26, 1950, and the Commission issued an order dated October, 26, 1950, which was filed on November 15, 1950, authorizing the Hilo Gas Company to sell its utility assets to Honolulu Gas Company.

(g) On October 31, 1950, the stockholders of Hilo Gas Company authorized the sale of the utility assets of the company to Honolulu Gas Company and the sale of the appliance and liquefied petroleum gas business and assets to Refiners. On October 31, 1950, Hilo Gas Company, Limited, executed a bill of sale transferring to Refiners the merchandise and liquefied petroleum gas business. On the same date, Hilo Gas Company and Honolulu Gas Company, Limited, executed an instrument whereby the Hilo Gas Company conveyed to the Honolulu Gas Company its utility plant and equipment, etc., and the Honolulu Gas Company assumed the liabilities of the Hilo Gas Company. Possession of these assets was not taken by the purchasers until after October 31, 1950.

(h) After the Public Utilities Commission approved the sale of the utility assets of Hilo Gas Company to Honolulu Gas Company, Limited, the necessary facilities for converting the Hilo system to butane air were ordered. The conversion of the system was completed in March of 1951, and on April 1, 1951, butane air gas was first supplied to the city of Hilo. Until April 1, 1951, all of the gas furnished to the city of Hilo was manufactured in the old plant of Hilo Gas Company. The old plant was retained as a stand-by facility for a month or so after April 1, 1951, until it could be ascertained that the butane air system was operating properly. Thereafter, such of the manufacturing facilities of the old plant as were not used in the butane air system were abandoned, scrapped or transferred to the Honolulu division of the Honolulu Gas Company, Limited.

(i) Hilo Gas Company suffered a net loss of $122,930.58 on the sale of its utility assets and franchise to Honolulu Gas Company, Limited. The net loss of Hilo Gas Company for 1950 was $117,792.57.

(j) Refiners and Hilo Gas Company filed consolidated federal income tax returns for the years 1950-1953, inclusive. They filed separate returns for the years 1954 and 1955. Hilo Gas Company, Limited, filed separate Territorial income tax returns for the years 1950-1955, inclusive.

(k) Hilo Gas Company filed annual corporate exhibits required by Territorial law for the years 1950-1955. In 1951 it reported in this corporate exhibit total income of $19,294.16, total expenses of $18,324.96 and a net income (before taxes) of $969.20. In 1952, it reported a total income of $10,732, total expenses of $10,273 and a net income (before taxes) of $459. In 1953, it reported a total income of $8,600, total expenses of $5,830.71 and a net income (before taxes) of $2,769.29. In 1954, it reported total income of $8,600, total expenses of $6,009 and net income (before taxes) of $2,590. In 1955, it reported total income of $8,700, total expenses of $6,063 and net income (before taxes) of $2,636. Hilo Gas Company was dissolved effective September 18, 1956.

(l) In the year 1950, Refiners suffered a loss of $93,092. In 1951, it had a net income of $17,445 and in 1952 a net income of $39,147. It did not have to pay any net income taxes for those years. In 1953, Refiners had a net income (before net income taxes) of $206,397.20, and in 1954, it had a net income (before net income taxes) of $215,735.66. All of the foregoing figures are on an unconsolidated basis.

(m) Refiners included the net loss from the sale in 1950 of the operating assets and franchise of the Hilo Gas Company, Limited, in computing the net operating loss carry-over to subsequent years, in the consolidated income tax returns timely filed for Refiners and Hilo Gas Company. The Commissioner of Internal Revenue has disallowed this item. The explanation given in the statement attached to the 150-day letter of the Appellate Division dated May 15, 1957, is as follows:

"On your return for the calendar year 1953, you claimed a net operating loss deduction of $145,-325.46. Included in this figure is an amount of $116,405.64 allegedly representing a net loss carry-over of Hilo Gas Company, Ltd., originating in the year 1950, computed as follows:

Purported loss from sale of utility assets to Honolulu Gas Company, Ltd., on October 31, 1950..		$122,930.58
Less:		
Net operating profit—Hilo Gas Company, Ltd.—1950	$5,138.01	
Net operating profit—Hilo Gas Company, Ltd.—1951	969.20	
Net operating profit—Hilo Gas Company, Ltd.—1952	417.73	6,524.94
Net operating loss carry-over claimed as deduction in 1953		$116,405.64

Affiliation with Hilo Gas Company, Ltd., occurred some time in October, 1950.

"It is held that, in substance, no deductible loss was sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in 1950. In the event that a loss was sustained as a result of this transaction, it is held that such loss may not be included as a part of a consolidated net loss reported on a consolidated return filed by Pacific Refiners, Ltd., as a parent, and Hilo Gas Company, Ltd., as subsidiary, for the calendar year 1950 since the loss, if any, was sustained in, or was allocable to, the period prior to affiliation and before the consolidation became effective. Accordingly, the net loss, if any, sutained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in the year 1950 may not be claimed as a part of the net operating loss deduction against the income of Pacific Refiners, Ltd., in the year 1953. The deduction claimed of $116,405.64 is therefore, disallowed."

(n) On June 4, 1957, Hawaiian Trust Company, Limited, as trustee in dissolution of Refiners, paid a deficiency of $58,472.39, together with interest of $11,301.99, assessed against Refiners by the Commissioner for 1953 on account of his disallowance of the carry-over to 1953 of the net operating loss suffered by Hilo Gas Company in 1950 upon the sale of the utility assets to Honolulu Gas Company, Limited. Said payment was made to the District Director of Internal Revenue in Honolulu.

(o) Plaintiff alleges that all of the foregoing sums were erroneously paid and illegally assessed and collected.

(p) On August 28, 1957, plaintiff, as trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the District Director of Internal Revenue in Honolulu for the year 1953 covering said principal amount of $58,472.39 and said payment of interest of $11,301.99. A true copy of said Claim for Refund is attached hereto, marked Exhibit A and by reference made a part hereof. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954 and its predecessor sections of the Internal Revenue Code of 1939. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

(q) On October 23, 1957, a Notice of Disallowance in full of plaintiff's Claim for Refund of $69,774.38 for the year 1953 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 3772(a), Internal Revenue Code of 1939. A true copy of said Notice of Disallowance is attached hereto, marked Exhibit B and by reference made a part hereof.

V.

The Commissioner's action in disallowing the 1950 net operating loss carry-over and in assessing and collecting said deficiency and interest for 1953 was erroneous and illegal for the following reasons:

(a) Section 141(a), Internal Revenue Code of 1939, extends to an affiliated group of corporations the privilege of making a consolidated return. Section 141(d) defines an affiliated group as one or more chains of includible corporations connected through stock ownership (95%) with a common parent corporation. Section 141(e) defines an includible corporation as any corporation except an exempt corporation and others, none of which exemptions or exceptions are applicable here. Refiners and Hilo Gas Company became affiliated corporations prior to October 25, 1950, and met the statutory requirements for filing consolidated returns. Regulation 129, Section 24.11(c) provides that an affiliated group remains in existence as long as there is a common parent and at least one subsidiary remains affiliated with it. Accordingly, the affiliated group in this case remained in existence until Hilo Gas Company was dissolved in September, 1956.

(b) A loss of $122,930.58 was sustained by Hilo Gas Company on the sale of its utility assets to Honolulu Gas Company, Limited, on October 31, 1950. This loss took place on that date and not at any other time. This loss took place after affiliation with Refiners. The loss was an ordinary loss. Consequently, under the Code (Sections 23(f), 117(j), 122 and 141 of the Internal Revenue Code of 1939), the income tax regulations and the consolidated return regulations, Hilo Gas Company was entitled to a deduction for this loss, and Refiners was entitled to include this loss in its consolidated net operating loss for 1950 and to carry it forward in full as a consolidated net operating loss carry-over to 1953.

VI.

No amount has been paid or refunded to plaintiff on account of said sums of $58.472.39 (principal) and $11,301.99 (interest) claimed as income tax and interest by defendant for the taxable year 1953 and erroneously and illegally assessed and collected by defendant from plaintiff.

VII.

The facts upon which plaintiff's claim for the year 1955 is based are as follows:

(a) The stockholders of Refiners on November 25, 1955, adopted a plan of complete liquidation providing for the sale of Refiners' refinery and related assets to Standard Oil Company of California and the sale of the Isle Gas business and related assets to Honolulu Gas Company, Limited, and thereafter the winding up of Refiners' business and the distribution of its assets and the dissolution of the corporation. In its tax return for the year 1955, Refiners claimed a deduction for organization expenses of $43,163.48. Included therein was the amount of $30,678.62 relating to expenses in connection with the issue of capital stock. These expenses are made up as follows:

Expenses of stock issue, date of offer May 8, 1950	$ 9,830.48	
Less: Federal stamp taxes	570.74	$ 9,259.74
Expenses of stock issue, date of offer April 29, 1951	22,243.99	
Less: Federal stamp taxes	825.11	21,418.88
Total expenses of marketing stock		$30,678.62

With respect to this item, the statement attached to the Appellate Division 150-day letter dated May 15, 1957, states:

"It is held that these expenses incurred in marketing your capital stock do not constitute organization expenses but serve to reduce the proceeds derived from the sale of the stock and are properly chargeable against the paid-in capital. The deduction of $30,678.62 claimed is, therefore, disallowed."

(b) Refiners in its 1955 income tax return claimed a deduction for accrued Territorial net income taxes of $67,648.77, based on the net income reportable for Territorial net income tax purposes, which income included (1) the gain from the sale of refinery facilities and related assets to Standard Oil Company of California and (2) the gain from the sale of the Isle Gas business and related assets to Honolulu Gas Company, Limited, in December, 1955.

(c) The total Territorial income tax paid by Refiners for the calendar year 1955 was $74,408.15, of which $59,089.97 was paid at the time of filing its return and $15,318.18 was paid in 1956 as the result of a deficiency assessed by the Territorial Tax Collector in that year.

(d) Under the provisions of Section 337, Internal Revenue Code of 1954, no gain for Federal income tax purposes was recognized to Refiners from the sale of said assets.

(e) The Commissioner has disallowed the portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets under the provisions of Section 265 of the Internal Revenue Code of 1954, stating in his 150-day letter that said section "prohibits the deduction of expenses allocable to income exempt from federal income tax." The amount of the total Territorial net income tax of $74,408.15, allocable to these gains and disallowed by the Commissioner for federal income tax purposes, was $61,061.59.

(f) On June 4, 1957, Hawaiian Trust Company, Limited, as trustee in dissolution of Refiners, paid a deficiency of $51,468.20, together with interest of $3,771.98 assessed against Refiners by the Commissioner for 1955, principally because of his disallowance of the capital stock expenses ($30,678.62) and his disallowance of 1955 Territorial income taxes ($61,061.59), as set forth above. Said payment was made to the District Director of Internal Revenue in Honolulu.

(g) Plaintiff alleges that the sum of $51,219.79 plus interest of $3,753.77 was erroneously paid and illegally assessed and collected.

(h) On August 28, 1957, plaintiff, as trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the District Director of Internal Revenue in Honolulu for the year 1955 in the amount of $51,219.79 plus interest of $3,753.77, or a total of $54,973.56. A true copy of said Claim for Refund is attached hereto, marked Exhibit C and by reference made a part hereof. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

(i) On October 23, 1957, a Notice of Disallowance in full of plaintiff's claim for refund of $54,973.56 for the year 1955 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 6532 (a)(1), Internal Revenue Code of 1954. A true copy of said Notice of Disallowance is attached hereto, marked Exhibit D and by reference made a part hereof.

VIII.

The Commissioner's action in disallowing the capital stock expense as a deduction and in disallowing any portion of the 1955 Territorial income taxes as a deduction and in assessing and collecting said deficiency and interest for 1955 to the extent of $54,973.56 was erroneous and illegal for the following reasons:

(a) The capital stock expenditures in question were made at about the time of the completion of Refiners' refinery and were made for the purpose of raising working capital. They are in the nature of or are similar to initial organization expenses, and as such should be allowed as deductions in the year Refiners resolved to cease business or, in any event, in the year of its dissolution. Such expenses are just as essential to the successful operation of a corporation as the expenses incurred in obtaining a corporate charter, for without capital, the charter itself is valueless. These latter expenses are deductible in full in the year of liquidation or dissolution, and the same treatment should be afforded to these capital stock expenditures.

(b) Capital gains not recognized because of the provisions of Section 337, Internal Revenue Code, do not constitute income "wholly exempt from taxes" within the meaning of Section 265(1). Consequently, the Territorial income tax on such gains is deductible in full under Section 164, and the total Territorial income tax for 1955 of $74,408.15 should have been allowed as a deduction by the Commissioner.

IX.

No amount has been paid or refunded to plaintiff of said sums of $51,219.79 (principal) and $3,753.77 (interest) claimed as income tax and interest by defendant for the taxable year 1955 and erroneously and illegally assessed and collected by defendant from plaintiff.

X.

Plaintiff is justly entitled to recover from defendant said total sum of $109,692.18 (principal) and $15,055.76 (interest) plus interest on the entire amount of principal and interest paid, as provided by law. Plaintiff has observed and performed the provisions and requirements of the laws of the United States, and the rules and regulations prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury, and all other matters and things necessary to be observed and performed on its part, to entitle it to recovery of said sums.

Wherefore, plaintiff prays judgment against defendant in the sum of $124,747.94, together with interest as in such cases is provided by law, and the costs of this suit, and that process issue out of this court requiring defendant to appear and answer this Complaint.

Dated at Honolulu, Hawaii, this 28th day of January, 1958.

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

ANDERSON, WRENN & JENKS,
Of Counsel.

[Endorsed]: Filed January 28, 1958.

[Title of District Court and Cause.]

ANSWER

Now comes the United States of America, the above-named defendant, by its attorney, Louis B. Blissard, United States Attorney in and for the District of Hawaii, and for its answer to the complaint filed herein alleges and says:

1.

Admits the allegations contained in paragraph numbered I thereof, except that it is denied that the taxes and interest sought to be recovered in this action were erroneously and illegally assessed and collected, as alleged in said paragraph.

2.

Admits the allegations contained in paragraph numbered II thereof.

3.

Admits the allegations contained in paragraph numbered III thereof, except that it is denied that the income taxes sought to be recovered herein were illegally and erroneously assessed and collected from plaintiff, and except that it is denied that there were overassessments and overpayments by plaintiff for the years 1953 and 1955, as alleged in said paragraph.

4.

Answering paragraph numbered IV thereof, the defendant alleges as follows:

(a) Admits the allegations contained in subparagraph (a) thereof.

(b) The defendant is presently without knowledge or sufficient information with respect to the truth of the allegations contained in subparagraphs (b), (c), (d), (e), (f), (g) and (h) thereof.

(c) Denies the allegations contained in subparagraph (i) thereof.

(d) Admits that Refiners and Hilo Gas Company filed returns purporting to be consolidated Federal income tax returns for the years 1950 to 1953, inclusive, as alleged in subparagraph (j) thereof, except that it is denied that said companies had the right to file consolidated returns for those years. Further answering said subparagraph, the defendant admits that separate Federal income tax returns were filed by Refiners and Hilo Gas Company for the years 1954 and 1955. The defendant has no present knowledge or sufficient information as to whether Hilo Gas Company filed separate Territorial income tax returns for the years 1950 to 1955, inclusive, as alleged in said subparagraph.

(e) The defendant has no present knowledge or sufficient information as to the truth of the allegations contained in subparagraph (k) thereof.

(f) Admits the allegations contained in subparagraph (l) thereof, except that the defendant is at present without knowledge or information as to the correct amount of loss suffered by Refiners in the year 1950, nor the correct amount of taxable income of Refiners for the years 1951, 1953 and 1954, as alleged in said subparagraph.

(g) Admits the allegations contained in subparagraph (m) thereof, except that it is denied that there was a loss allowable or deductible resulting from the sale in 1950 of the operating assets and franchise of Hilo Gas Company, Ltd.

(h) Admits the allegations contained in subparagraph (n) thereof.

(i) Denies the allegations contained in subparagraph (o) thereof.

(j) Admits the allegations contained in subparagraph (p) thereof, except that the allegations contained in the claim for refund, copy of which is attached to the complaint as Exhibit A, are denied.

(k) Admits the allegations contained in subparagraph (q) thereof.

5.

Denies the allegations contained in paragraph numbered V thereof, except that the allegations contained in subparagraph (a) therof are admitted, with the exception that it is denied that Refiners and Hilo Gas Company were affiliated corporations prior to October 25, 1950, or at any other time, and met the statutory requirements for filing consolidated returns, as alleged in said subparagraph, and except that the allegations contained in subparagraph (b) thereof are denied.

6.

Admits the allegations contained in paragraph numbered VI thereof, except that it is denied that the income tax and interest referred to in said paragraph were erroneously and illegally assessed and collected by the defendant from plaintiff.

7.

Answering paragraph numbered VII thereof, the defendant alleges as follows:

(a) Admits the allegations contained in subparagraph (a) thereof, except that the defendant is at present without knowledge or sufficient information as to the truth of the allegations contained in the first sentence of said subparagraph.

(b) Admits the allegations contained in subparagraphs (b), (c), (d) and (e) thereof.

(c) Admits the allegations contained in subparagraph (f) thereof, except that $35,670.31 of the deficiency of $51,468.20, plus interest of $3,850.90, instead of $3,771.98, assessed against plaintiff was paid on June 4, 1957, that $1,560.73 of said assessment was paid on July 26, 1957, and that the balance of $18,088.13 was satisfied by credit on July 24, 1957.

(d) Denies the allegations contained in subparagraph (g) thereof.

(e) Admits the allegations contained in subparagraph (h) thereof, except that the allegations contained in the claim for refund, attached to the complaint as Scedule C, are denied.

(f) Admits the allegations contained in subparagraph (i) thereof.

8.

Denies the allegations contained in paragraph numbered VIII and subparagraphs (a) and (b) thereof.

9.

Admits the allegations contained in paragraph numbered IX thereof, except that the defendant denies that the income tax and interest referred to in said paragraph was erroneously and illegally assessed and collected by defendant from plaintiff.

10.

Denies the allegations contained in paragraph numbered X thereof.

Wherefore, defendant prays that the complaint filed herein be dismissed, with costs to be assessed against the plaintiff.

/s/ E. C. CRUMPACKER,
Asst. United States Attorney,
Attorney for Defendant.

Receipt of copy acknowledged.

[Endorsed]: Filed March 27, 1958.

[Title of District Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys that the following statements of fact shall be considered as true and in evidence. It is also agreed by and between the parties hereto that they may also offer any other evidence, oral, documentary or otherwise, in the trial of this case, provided such additional evidence shall not vary or in any way contradict with the statements heretofore taken to be true, and provided further that such additional evidence is properly admissible.

I.

Pacific Refiners, Limited (hereinafter called Refiners) was organized as a corporation under the laws of the Territory of Hawaii on May 31, 1949. Refiners was dissolved on November 19, 1956, and Hawaiian Trust Company, Limited (hereinafter called the plaintiff), was appointed Trustee for the creditors and stockholders in accordance with the laws of the Territory of Hawaii.

II.

Refiners had an initial authorized capital of $250,000 represented by 250,000 shares of common stock of the par value of $1.00 per share. Honolulu Gas Company, Limited (hereinafter called Honolulu Gas), a Hawaii public utility corporation, operating a manufactured gas business on the Island of Oahu, purchased at par the initial 250,000 shares of common stock of Refiners, and in August of 1949, distributed such stock as a dividend to the stockholders of Honolulu Gas. After its organization, Refiners engaged in the merchandising of gas appliances and commenced construction of its refinery. In order to pay for construction expenditures, it borrowed $650,000 on short-term promissory notes. In May of 1950, Refiners sold to the public (through a rights offering) an additional 500,000 shares of common stock and $750,000 principal amount of fifteen-year, 6% sinking fund debentures. The net proceeds of this issue were estimated at $1,225,445. Refiners' prospectus relating to this issue stated with respect to the application of the proceeds from the offering:

"Of such net proceeds, $650,000 will be applied to pay $650,000 principal amount of the Company's short-term promissory notes * * *. The balance of such net proceeds will be added to the general funds of the Company and will be available for the payment of capital expenditures during 1950, the reimbursement of the Company for construction expenditures already made, or for other corporate purposes."

In this connection with this offering, Refiners incurred expenditures attributable to the issuance of its shares of common stock (principally attorneys' fees, printing expenses, accountants' fees and charges of the stock subscription agent) in the amount of $9,259.74. In December of 1950, Refiners completed the construction of its refinery at a cost somewhat in excess of its estimate. In April of 1951, Refiners sold an additional 750,000 shares of common stock to the public (through a rights offering). The net proceeds from this issue were estimated at $734,400. In respect to such proceeds, the prospectus stated:

> "$600,000 of such proceeds will be applied to pay a like face amount of the Company's short-term promissory notes. These notes or other notes refunded by them represent moneys borrowed to pay for construction expenditures and to carry inventories and receivables or to replace treasury funds previously expended for such purpose. The balance of such proceeds will be added to the general funds of the Company and will be available for the reimbursement of the Company for construction expenditures previously made or for other corporate purposes."

In connection with this issue, Refiners incurred capital stock expenses (principally attorneys' fees, printing expenses, accountants' fees and charges of the stock subscription agent) in the amount of $21,418.88.

III.

Refiners' principal business was the manufacture and sale of petroleum products and the distribution of butane (a form of liquefied petroleum gas) in the Territory of Hawaii. Refiners was not a public utility, and none of its business was subject to regulation by the Public Utilities Commission of the Territory of Hawaii. Refiners entered into an oil and butane contract with Standard Oil of California (hereinafter called Standard) in August of 1949 for a period of ten years for the purchase of petroleum oil and butane. The butane was blended by Standard into heavy gas oil and shipped to Refiners in Honolulu. Refiners at its refinery in Honolulu separated the butane from the gas oil. The butane thus obtained was liquefied and stored by Refiners in pressure tanks, ready for distribution and sale. The butane-free gas oil was then passed through a further process which removed diesel oil and similar fractions contained in the original oil, leaving asphalt. The gas oil was then sold to Honolulu Gas for its use in the manufacture of gas. Under this contract with Standard, Refiners was required to purchase a substantial minimum amount of heavy gas oil blended with butane. For the first contract year the minimum amounts were 450,000 barrels of oil and 650,000 gallons of butane; for the second year the minimum amounts were 500,000 barrels of oil and 1,450,000 gallons of butane; for each contract year thereafter the minimum amounts were 500,000 barrels of oil and 1,700,000 gallons of butane. The Hilo Gas Company, Limited (hereinafter called Hilo Gas), distribution system, after its conversion to butane air in 1951, used in excess of 500,000 gallons of butane annually, accounting for about one-third of the total butane sales of Refiners.

IV.

Hilo Gas was organized as a corporation under the laws of the Territory of Hawaii in 1927. It engaged in the business of manufacturing gas from oil and distributing it through gas mains in the City of Hilo. It was a public utility subject to regulation by the Public Utilities Commission. In 1948 and 1949 the company lost money and was in financial difficulty. In the spring of 1950, Mr. A. E. Englebright, who was then the general manager of Refiners, was approached by Mr. Orlando Lyman, the president and the largest stockholder of Hilo Gas, for assistance in solving the problems of Hilo Gas. The proposition was made that Hilo Gas cease the manufacture of gas from oil and buy butane from Refiners, which Hilo Gas would then distribute through its gas mains in the City of Hilo as a public utility. This would save manufacturing costs and reduce gas rates to a point where they might be competitive with electric rates. The minutes of the Executive Committee of Refiners for May 10, 1950, state:

> "The General Manager and the Secretary reviewed the findings of their recent trip to Hawaii taken for the purpose of determining the best outlet for butane on that island. It was reported that the Hilo Gas Company wished to enter into an arrangement whereby they would convert their manufactured gas facilities to a butane-air or butane-vapor operation and that, in conjunction with this, they wished to obtain

> a franchise for the distribution of butane throughout the entire Island of Hawaii."

The feasability of the Hilo Gas plan depended to some extent on the condition of its gas mains. Mr. Englebright sent Mr. L. L. Gowans, chief engineer of Honolulu Gas, to Hilo to make a survey. Mr. Gowans made a report, dated June 14, 1950, which concluded that the gas mains were in adequate condition and that it would be entirely feasible and desirable to distribute a butane air mix in the Hilo Gas distribution system without too great a loss in leakage. After these reports and conversations with the principals, Refiners, on August 7, 1950, made a proposal to Mr. Lyman that it supply Hilo Gas with butane at 16c per gallon, based on the present posted price of butane in San Francisco. Refiners would also provide equipment and appurtenances for butane air installation at the Hilo plant at a cost of approximately $25,000, to be repaid by Hilo Gas through an additional 1c per gallon payment for all butane used in its system. Mr. Lyman expressed interest in this proposal, but in addition wished to acquire the franchise for distribution of "Isle-Gas" (Refiners' trade name for butane which it distributed in tanks or containers for use by rural customers) throughout the Island of Hawaii at the price quoted for use in the Hilo Gas mains. On August 31, 1950, Mr. Englebright wrote Mr. Lyman that Refiners could not go along with his proposal to include the North Hilo and Puna districts with Hilo proper for a combination utility and non-utility operation, with butane to be supplied at the price which Refiners had proposed for Hilo Gas only. He said that Refiners was prepared to go ahead with the conversion proposal stated in the letter of August 7, but that it could not guarantee that Isle-Gas installations (which would be handled by other parties) would not compete directly with Hilo Gas service. This might be serious, said Mr. Englebright, as the cooking load (the only profitable load of Hilo Gas) could be served more cheaply with Isle-Gas than with gas from the mains of Hilo Gas. Mr. Englebright suggested that it might be wisest for Hilo Gas to discontinue operations as a public utility (that is, distribution of gas through city gas mains) and instead convert all appliances of its customers to a butane-vapor operation, hooking them up to butane tanks (Isle-Gas). He said that he thought that this would cost about $125,000, but would be a successful operation. This alternative proposal was not acceptable to Mr. Lyman. However, about the middle of September, 1950, Mr. Lyman offered to sell his stock in Hilo Gas to Refiners or to Honolulu Gas. With the exception of the foregoing negotiations with Refiners, neither Mr. Lyman nor any other of the stockholders or management of Hilo Gas had any plans for renovation or conversion of the Hilo Gas system or the abandonment or scrapping of the manufactured gas plant.

V.

On September 16, 1950, the Executive Committee of Refiners met to consider Mr. Lyman's proposal. The minutes of this meeting state:

> "The manager stated that we had been approached by the majority stockholder [Mr. Lyman] of the Hilo Gas Company with the proposal that he dispose to us his holdings of that company, at a price that appeared to be advantageous from our standpoint. Another stockholder [Mr. Hutchinson] has slightly less than 30% of the balance of shares of Hilo Gas Company and it seems likely that they could be obtained for a reasonable price. Together the two holdings would more than exceed the 75% required to liquidate the corporation."

Mr. Englebright reviewed the advantages of the purchase of the Hilo Gas stock to provide an assured outlet for butane on the Island of Hawaii. He stated that in view of Refiners' commitment to Standard to purchase minimum amounts of butane, it was necessary or highly desirable to obtain this Hilo outlet, plus the non-utility business of Hilo Gas—the distribution of liquefied petroleum gas (called "Rock Gas") in tanks to rural customers beyond the city gas mains. Also, Refiners' new refinery was scheduled for completion in the fall of 1950 (actually completed in December), and it was necessary to find outlets for its butane production. Mr. Englebright stated that unless an attempt was made to perpetuate Hilo Gas, it would probably be dissolved (particularly as certain of its stockholders were also interested in the Hilo Electric Company), and this would serve as an obstacle to expanding gas sales, not only in Hilo, but also in other parts of the Island of Hawaii. Purchase of the stock would also assure Refiners of control of the non-utility ("Rock Gas"*) business of Hilo Gas in the outlying districts of the Island of Hawaii. Another meeting of the Executive Committee of Refiners was held on September 26, 1950, at which the Hilo Gas situation was discussed. On September 27, 1950, at a meeting of the Board of Directors of Honolulu Gas, management presented a plan for the purchase of the utility assets of Hilo Gas. At this meeting a motion was adopted authorizing the acquisition of the assets of Hilo Gas at a price not to exceed $75,000, subject to the approval of the Public Utilities Commission. On October 3, 1950, an option was obtained by Refiners from Mr. Lyman granting to Refiners an option to purchase his shares for $35,000 for a period of seven days from the date of the option, subject to the condition that the purchaser obtain options to purchase not less than 75% of each of the outstanding classes of stock of Hilo Gas. There were 2,283 shares of 8% preferred stock, 1,929 shares of 7% preferred stock and no common stock outstanding. Both the 8% preferred stock and the 7% preferred stock were voting shares. Mr. Lyman owned 1,431 shares of the 8% preferred

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*"Rock Gas" was the trade name for the liquefied petroleum gas distributed by Hilo Gas. It was substantially similar to and competitive with Refiners' product known as "Isle Gas."

stock and 865 shares of the 7% preferred stock. Also on October 3, 1950, Refiners obtained a similar option from Mr. Hutchinson, who owned 747 shares of 8% preferred stock and 492 shares of 7% preferred stock, for a price of $18,832.80. On October 5, 1950, the Board of Directors of Refiners authorized the purchase by it of all of the stock of Hilo Gas.

VI.

The Hilo Gas stock was purchased by Refiners, rather than by Honolulu Gas, because Refiners, as the distributor of butane, had the primary interest in securing the Hilo market. On August 31, 1950, Mr. Englebright had recommended to Mr. Lyman that, as other solutions had failed, Hilo Gas should discontinue the distribution of gas through mains and distribute butane in tanks to customers. This would have resulted in a non-utility business of no interest to Honolulu Gas, but would have left Hilo Gas as a large butane customer of Refiners. Also, Refiners wished to acquire the non-utility "Rock Gas" business of Hilo Gas in outlying districts on the Island of Hawaii. Another reason for the purchase of the stock by Refiners, rather than by Honolulu Gas, was that an order of the Public Utilities Commission would have been necessary before Honolulu Gas could act to purchase the stock, whereas no such order was required in the case of Refiners, which was not a public utility, and it was the view of the management of Refiners that quick action was necessary. Further, the purchase of Hilo

Gas stock by Honolulu Gas would have made the latter company a public utility holding company under federal law, a situation which Honolulu Gas wished to avoid.

VII.

The stock of Messrs. Lyman and Hutchinson was sold to Refiners on October 6, 1950. At about the same time Refiners also purchased the largest blocks of stock held by other stockholders. On October 21, 1950, a letter was sent to the remaining stockholders of Hilo Gas offering to purchase their shares at the same price, and pursuant to this offer, Refiners purchased before October 25 most of the outstanding shares of both classes held by minority stockholders. Prior to October 25, 1950, Refiners had acquired 95% or more of the outstanding capital stock of Hilo Gas. On October 25, 1950, the general manager reported to the directors of Refiners that 96% of the stock of Hilo Gas had been acquired by Refiners—all but 164 shares. At a hearing before the Public Utilities Commisison on October 26, 1950, Mr. K. A. Conningham, Assistant Treasurer of Refiners, testified that Refiners had purchased approximately 95% of the capital stock of Hilo Gas from various stockholders and that the acquisition was completed "about ten days ago." Refiners never acquired more than 1,872 of the 1,929 outstanding shares of the 7% preferred stock of Hilo Gas and did not acquire the last minority-owned share of the 8% preferred stock until shortly before the dissolution of Hilo Gas in September, 1956. The total cost to Refiners of the Hilo Gas stock purchased by it was $63,897.20.

VIII.

Under the Hawaii law, no public utility may sell, lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its road, line, plant system or other property necessary or useful in the performance of its duties to the public without first having secured from the Public Utilities Commission an order authorizing it to do so, and every such sale, lease, assignment, mortgage, disposition or encumbrance made other than in accordance with the order of the Commission shall be void (§104-18, RLH 1955). On October 20, 1950, Hilo Gas filed a petition with the Public Utilities Commission in which it recited that it proposed to sell all of its assets, except its merchandise, goods, notes and accounts receivable related to the appliance sales business and its liquefied petroleum gas business, to Honolulu Gas for approximately $60,000, the exact price to be determined at its meeting of stockholders called to approve of such sale. The hearing on this application was held on October 26, 1950, at which the applicant presented its case. The Commission issued an order dated October 26, 1950, which was filed November 15, 1950, authorizing Hilo Gas to sell its utility assets to Honolulu Gas for a total consideration of approximately $64,000, consisting of a cash payment of approximately $46,000 and the assumption by the purchaser of outstanding utility liabilities in the amount of approximately $18,000. A copy of said order is attached hereto as Exhibit 1 and made a part hereof.

IX.

Under the Hawaii law, the sale of substantially all of the property of a corporation requires the affirmative vote of three-fourths of all stock issued and outstanding and having voting power (§170-30, RLH 1955). At a meeting held October 31, 1950, the stockholders of Hilo Gas, by the necessary vote, authorized the sale of the utility assets of the company to Honolulu Gas and the sale of the appliance and liquefied petroleum gas business and assets to Refiners. On October 31, 1950, Hilo Gas executed a bill of sale transferring to Refiners for $18,500 the merchandise, bottled gas and gas appliances and the notes and accounts receivable relating to the appliance sales business and the liquefied petroleum gas business. On October 31, 1950, Hilo Gas and Honolulu Gas executed an instrument whereby Hilo Gas conveyed to Honolulu Gas for $46,000 its utility manufacturing plant and equipment, its distribution system and other utility assets, and Honolulu Gas assumed the liabilities of Hilo Gas. Possession of these assets was not taken by the purchasers until after October 31, 1950.

X.

On October 31, 1950, Hilo Gas sold assets having a basis for tax purposes of $211,684.90 to Honolulu Gas and Refiners for a total consideration of $88,-

754.32. Said consideration consisted of cash in the amount of $46,000 paid by Honolulu Gas, cash in the amount of $18,500 paid by Refiners and assumption of liabilities in the amount of $25,254.32 by Honolulu Gas. Honolulu Gas acquired cash, land, buildings and improvements, manufacturing plant, distribution system, machinery and equipment and a portion of the accounts receivable, inventories and supplies. Refiners acquired merchandise, supplies, notes and accounts receivable and inventories relating to the gas appliance sales business and the liquefied petroleum gas business. The land, cash, accounts receivable, merchandise, inventories and supplies were sold at their net book value, so no gain or loss was realized on such sale. The buildings and improvements, the manufacturing plant and equipment, the distribution system and the related facilities (all utility assets) were sold to Honolulu Gas at $122,930.58 less than their net book value. Said utility assets sold to Honolulu Gas consisted of "property used in the trade or business" as defined in Section 111(j)(1), Internal Revenue Code of 1939.

XI.

After the Public Utilities Commission approved the sale of the utility assets of Hilo Gas to Honolulu Gas, the necessary facilities for converting the Hilo system to butane air were ordered. The conversion of the system was completed in March of 1951, and on April 1, 1951, butane air gas was first supplied to the City of Hilo. Until April 1, 1951, all of the gas furnished to the City of Hilo was manufactured in the old plant of Hilo Gas. The old plant was retained as a stand-by facility for a month or so after April 1, 1951, until it could be ascertained that the butane air system was operating properly. Thereafter, such of the manufacturing facilities of the old plant as were not used in the butane air system were abandoned, scrapped or transferred to the Honolulu Division of Honolulu Gas. The gas mains and distribution system of Hilo Gas were continued in use by Honolulu Gas. Hilo Gas had never claimed an obsolescence or abandonment loss for tax purposes on any of the utility assets sold by it to Honolulu Gas on October 31, 1950. The utility assets sold to Honolulu Gas on October 31, 1950, and abandoned, scrapped or transferred to the Honolulu Division by Honolulu Gas after April 1, 1951, were as follows:

Class of Assets	Net Book Value at October 31, 1950
Boiler Plant Equipment	$ 10,684.48
Equipment and Generators	22,688.88
Purification Equipment	9,976.69
Other Production Equipment	5,485.52
Pumping Equipment	2,568.15
Service Equipment	1,435.93
Total	$ 52,839.65

Utility assets (other than cash, receivables, inventories and supplies) sold to Honolulu Gas on October 31, 1950, which were continued in use in the Hilo operations of Honolulu Gas after April 1, 1951, were as follows:

Class of Assets	Net Book Value at October 31, 1950
Structures and Improvements	$ 11,608.95
Production Equipment	4,588.30
Storage Plant	6,309.92
Gas Mains	42,180.91
Pumping Equipment	2,281.00
Service Equipment	13,793.03
Meters	18,671.57
Office Equipment	4,199.60
Shop Equipment	39.62
Warehouse	2,396.43
Leasehold Improvements	472.77
Tools and Equipment	1,271.60
Transportation Equipment	5,821.45
Total	$113,635.15

XII.

As a result of the sale of said utility assets to Honolulu Gas for $122,930.58 less than their net book value, Hilo Gas claimed a net operating loss of $117,792.57 for 1950.

XIII.

The taxable year of both Refiners and Hilo Gas was the calendar year. Refiners and Hilo Gas filed consolidated federal income tax returns for the years 1950, 1951, 1952 and 1953. Refiners and Hilo Gas filed separate returns for the years 1954 and 1955. Both companies filed separate Territorial income tax returns for the years 1950-1955, inclusive.

XIV.

In the year 1950, Refiners suffered a loss of $93,-092. In 1951, it had a net income of $17,445 and in 1952, $39,147. It did not have to pay any federal or

Territorial income taxes in those years. In 1953, it had a net income before income taxes of $206,397.20 and after income taxes (as reported) of $167,229. In 1954, it had a net income before income taxes of $215,735.66 and after income taxes (as reported) of $104,977. All of the foregoing figures are on an unconsolidated basis.

XV.

Hilo Gas filed annual Corporation Exhibits required by Territorial law for the the years 1950-1955. In 1951, it reported on this exhibit total income of $19,294.16, total expenses of $18,324.96 and a net income (before taxes) of $969.20. In 1952, it reported a total income of $10,732.76, total expenses of $10,273.26 and a net income (before taxes) of $459.50. In 1953, it reported a total income of $8,600.00, total expenses of $5,830.71 and a net income (before taxes) of $2,769.29. In 1954, it reported total income of $8,600.00, total expenses of $6,009.25 and net income (before taxes) of $2,590.75. In 1955, it reported total income of $8,700.00, total expenses of $6,063.04 and net income (before taxes) of $2,636.96. Hilo Gas was dissolved effective September 18, 1956.

XVI.

At the time of the acquisition of the stock of Messrs. Lyman and Hutchinson on October 6, 1950, no consideration was given by Refiners to the tax aspects of the transaction. The officials of Refiners did not know what the book value of the Hilo Gas assets was, and the Hilo Gas books were not made available to Refiners until after the decision had been made to purchase the Lyman and Hutchinson stock. Mr. Lyman has stated that the principal purpose on taking over Hilo Gas was to sell butane not then used by Hilo Gas.

"As far as I know, no investigation was made into the accumulated losses of Hilo Gas or was the matter discussed at any time between Mr. Englebright and myself during the negotiations. The purpose of the purchase of Hilo Gas Co. was to do away with the old manufactured gas plant and replace it with butane shipped in from Pacific Refiners." (Letter of August 27, 1956.)

"Mr. Englebright and I at no time discussed the book value of the assets of Hilo Gas Company.

"It is also my recollection that your accounting staff did not arrive in Hilo until the day I left the company after the sale. This timing I recollect, as pay for my vacation time was left up to your staff. They refused payment. This incident, I believe, helps to place the correct timing of your accountant's access to the books. Mr. Englebright did not look over the books at any time before the purchase." (Letter of September 17, 1956.)

XVII.

It was not until November, 1950, that Refiners obtained advice on the tax aspects of the transaction. Mr. J. C. Rosebrook, the Treasurer of Refiners, consulted with Mr. H. C. Dunn, of Cameron, Tennet and Greaney, who wrote an opinion dated November 15, 1950, pointing out that the loss on the sale to Honolulu Gas would be an allowable deduction in a consolidated return filed by Refiners and Hilo Gas, but that this would not be an immediate benefit because Refiners did not have any net income. Mr. K. A. Conningham, treasurer of Honolulu Gas, consulted with Mr. A. L. Castle, of Messrs. Robertson, Castle & Anthony, concerning the tax aspects of the Hilo Gas transaction. Mr. Castle advised (opinion dated November 13, 1950, and memorandum dated November 11, 1950) that Honolulu Gas could not acquire the Hilo Gas assets at their book value under Sections 112(b)(6) and 113(a)(5) in order to take advantage of the loss sustained on the abandonment of the manufacturing plant. "If in advance the two sections of the Code had been considered whether we would have any ground to stand on is difficult to say * * *."

XVIII.

The original plan of the new controlling stockholder (Refiners) of Hilo Gas had been to sell the utility assets to Honolulu Gas, to sell the remaining assets to Refiners and to dissolve the corporation at such time as the directors of that company determined in their discretion to be convenient. Actually, Hilo Gas did not sell or distribute all its assets in 1950, and, in fact, it continued its corporate existence and activities until September 18, 1956, when it was dissolved by order of the Treasurer of the Territory of Hawaii. It continued to file the Annual Corporate Exhibit required by the Territorial Corporation Laws, to hold annual meetings of stockholders, to hold periodic meetings of directors, to have an independent auditor, to file federal and territorial income tax returns, to pay income taxes, to own property, to receive income and to pay expenses.

XIX.

On October 31, 1950, Hilo Gas sold to Honolulu Gas its utility assets for $46,000 and the assumption of liabilities. On the same date it transferred its merchandise and liquefied petroleum gas business to Refiners for $18,500. Hilo Gas retained certain assets in addition to the $64,500 cash received from the sale of its properties. These assets included merchandise parts inventory (for older types of appliances) amounting to $1,010.64, certain accounts receivable, and a lease of an office building in Hilo. The Hilo Gas balance sheet as of December 31, 1950, shows assets as follows: cash in bank—$14,498.76; notes receivable (Refiners—1% interest) $50,000; accounts receivable (other) $531.30; inventory $904.60; total $65,934.65. On the same date the balance sheet shows accounts payable of $647.97 and other current and accrued liabilities of $106.80, or total current liabilities of $754.77.

XX.

Until September, 1951, Hilo Gas maintained the payrolls, paid the office rent, and provided various other services for Refiners and Honolulu Gas on a cost-plus basis, the cost representing only enough to operate and not including the overhead. In September, 1951, the payroll was transferred to the main office of Honolulu Gas in Honolulu. Hilo Gas maintained a bank account with the Hilo branch of Bishop National Bank until its dissolution in 1956. On April 15, 1955, it entered into a ten-year lease of a butane distribution site with Hilo Sugar Plantation Company. On January 4, 1951, it entered into a lease of an office building at 202-206 Kamehameha Avenue, Hilo, with Adele F. Amiel for a period of two years with an option to renew for five years at a rental of $500 per month. This lease was surrendered in November of 1952. On October 15, 1952, Hilo Gas entered into a lease of an office building at 510 Kamehameha Avenue, Hilo, with C. L. Chow, et al., for a period of five years at a rental of $275 per month. This lease was assigned to Honolulu Gas in 1956 prior to dissolution, with the consent of the lessors. During the period it held these office building leases, Hilo Gas subleased space to Honolulu Gas and Refiners for their Hilo offices. During the period from October 31, 1950, to 1956, Hilo Gas received rental, interest and merchandising income and paid expenses, including a secretary's salary, lease expenses, office supplies, janitor service, directors' fees, pensions to retired employees and federal and territorial taxes. Its income and expenses for the years 1951-1955 are given in Paragraph XV above. Copies of the Annual Corporation Exhibits of Hilo Gas for the years ended December 31, 1951, December 31, 1952 and December 31, 1953, are attached hereto as Exhibit 2 and made a part hereof.

XXI.

On several occasions after 1951, the question of liquidating Hilo Gas was raised by various of the directors, but it was decided to maintain its corporate existence in view of the possible uses that might be made of the corporation. At one time discussions were held with the Bishop National Bank relative to the possibility of financing liquefied petroleum gas tank purchases through Hilo Gas. Discussions were also held with J. Barth & Co. in San Francisco and the Secretary of the Territorial Retirement System with respect to financing through Hilo Gas. The reason that Hilo Gas entered this picture was the fact that lending institutions were generally prohibited from investing in corporations of a relatively few years' existence, and as Refiners had experienced difficulty in financing for this reason, it was thought that Hilo Gas, with its longer record of corporate existence, might be useful. In addition, the possibility of giving Hilo Gas a franchise for the distribution of Isle-Gas on the Island of Hawaii was considered.

XXII.

Refiners included the net loss from the sale in October, 1950, of the utility assets of Hilo Gas to Honolulu Gas in computing the net operating loss carry-over to subsequent years, in the consolidated income tax returns timely filed for Refiners and Hilo Gas. The Commissioner of Internal Revenue has disallowed this item. The explanation given in the statement attached to the 150-day letter of the

Appellate Division dated May 15, 1957, is as follows:

"On your return for the calendar year 1953, you claimed a net operating loss deduction of $145,325.46. Included in this figure is an amount of $116,405.64 allegedly representing a net loss carry-over of Hilo Gas Company, Ltd., originating in the year 1950, computed as follows:

Purported loss from sale of utility assets to Honolulu Gas Company, Ltd., on October 31, 1950..		$122,930.58
Less:		
Net operating profit—Hilo Gas Company, Ltd.—1950	$5,138.01	
Net operating profit—Hilo Gas Company, Ltd.—1951	969.20	
Net operating profit—Hilo Gas Company, Ltd.—1952	417.73	6,524.94
Net operating loss carry-over claimed as deduction in 1953		$116,405.64

Affiliation with Hilo Gas Company, Ltd., occurred some time in October, 1950.

"It is held that, in substance, no deductible loss was sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in 1950. In the event that a loss was sustained as a result of this transaction, it is held that such loss may not be included as a part of a consolidated net loss reported on a consolidated return filed by Pacific Refiners, Ltd., as a parent, and Hilo Gas Company, Ltd., as subsidiary, for the calendar year 1950 since the loss, if any, was sustained in, or was allocable to, the period prior to affiliation and before the consolidation became effective. Accordingly, the net loss, if any, sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in the year 1950 may not be claimed as a part of the net operating loss deduction against the income of Pacific Refiners, Ltd., in the year 1953. The deduction claimed of $116,405.64 is, therefore, disallowed."

XXIII.

On June 4, 1957, plaintiff, as Trustee for the creditors and stockholders of Refiners, paid a deficiency of $58,472.39, together with interest of $11,301.99, assessed against Refiners by the Commissioner for 1953 on account of his disallowance of the carry-over to 1953 of the net operating loss suffered by Hilo Gas in 1950 upon the sale of the utility assets to Honolulu Gas. Said payment was made to the District Director of Internal Revenue in Honolulu.

XXIV.

On August 28, 1957, plaintiff, as Trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the District Director of Internal Revenue in Honolulu for the year 1953 covering said principal amount of $58,472.39 and said payment of interest of $11,301.99. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954 and its predecessor sections of the Internal Revenue Code of 1939. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

XXV.

On October 23, 1957, a Notice of Disallowance in full of plaintiff's Claim for Refund of $69,774.38 for the year 1953 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 3772(a), Internal Revenue Code of 1939.

XXVI.

No amount has been paid or refunded to plaintiff on account of said sums of $58,472.39 (principal) and $11,301.99 (interest) claimed as income tax and interest by defendant for the taxable year 1953 and assessed and collected by defendant from plaintiff.

XXVII.

The stockholders of Refiners on November 25, 1955, adopted a plan of complete liquidation which provided for the sale of the refinery facilities to Standard, the sale of the Isle-Gas business and related assets to Honolulu Gas and the liquidation and dissolution of the corporation. Pursuant to this plan, the refinery facilities were sold to Standard on December 6, 1955, and the Isle-Gas business and assets were sold to Honolulu Gas on December 31, 1955. Thereafter, and within a period of twelve months from the date of adoption of the plan of liquidation, the affairs of the corporation were wound up, all of the assets of the corporation were distributed in complete liquidation, less assets retained to meet claims, and the corporation was dissolved by order of the Treasurer of the Territory of Hawaii on

November 19, 1956. No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas as aforesaid, pursuant to the provisions of Section 337, Internal Revenue Code of 1954.

XXVIII.

In its tax return for the year 1955, Refiners claimed a deduction for organization expenses of $43,163.48. Included therein was the amount of $30,678.62 relating to expenses in connection with the issue of capital stock, $9,259.74 in 1950 and $21,418.88 in 1951. With respect to this item, the statement attached to the Appellate Division 150-day letter dated May 15, 1957, states:

"It is held that these expenses incurred in marketing your capital stock do not constitute organization expenses but serve to reduce the proceeds derived from the sale of the stock and are properly chargeable against the paid-in capital. The deduction of $30,678.62 claimed is, therefore, disallowed."

XXIX.

Refiners in its 1955 income tax return claimed a deduction for accrued territorial net income taxes of $67,648.77, based on the net income reportable for territorial net income tax purposes, which income included (1) the gain from the sale of refinery facilities and related assets to Standard and (2) the gain from the sale of the Isle-Gas business and related assets to Honolulu Gas in December, 1955. The total territorial income tax paid by Refiners for the calendar year 1955 was $74,408.15, of which

$59,089.97 was paid at the time of filing its return and $15,318.18 was paid in 1956 as the result of a deficiency assessed by the Territorial Tax Collector in that year. The Commissioner has disallowed the portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets under the provisions of Section 265 of the Internal Revenue Code of 1954, stating in his 150-day letter that said section "prohibits the deduction of expenses allocable to income exempt from federal income tax." The amount of the total territorial net income tax of $74,408.15, allocable to these gains and disallowed by the Commissioner for federal income tax purposes, was $61,061.59.

XXX.

The Commissioner assessed a deficiency of $51,-468.20, together with interest of $3,850.97, against Refiners for 1955, principally because of his disallowance of the capital stock expense ($30,678.62) and his disallowance of 1955 Territorial income taxes ($61,061.59) as set forth above. Plaintiff, as Trustee in dissolution of Refiners, paid said deficiency and interest to the District Director of Internal Revenue in Honolulu as follows: $35,670.31 on June 4, 1957; $1,560.73 on July 26, 1957; and the balance of $18,-088.13 by credit on July 23, 1957.

XXXI.

On August 28, 1957, plaintiff, as Trustee for the creditors and stockholders of Refiners, filed a duly executed Claim for Refund (Form 843) with the

District Director of Internal Revenue in Honolulu for the year 1955 in the amount of $51,219.79 plus interest of $3,753.77, or a total of $54,973.56. Said Claim for Refund was filed within the time prescribed by Section 6511, Internal Revenue Code of 1954. The form and contents of said Claim satisfy the requirements of the applicable Treasury Regulations.

XXXII.

On October 23, 1957, a Notice of Disallowance in full of plaintiff's Claim for Refund of $54,973.56 for the year 1955 was mailed to plaintiff by registered mail by the District Director of Internal Revenue, Honolulu, as provided in Section 6532 (a)(1), Internal Revenue Code of 1954.

XXXIII.

No amount has been paid or refunded to plaintiff of said sums of $51,219.79 (principal) and $3,-753.77 (interest) claimed as income tax and interest by defendant for the taxable year 1955 and assessed and collected by defendant from plaintiff.

Dated: Honolulu, T. H., this 28th day of November, 1958.

HAWAIIAN TRUST
COMPANY, LIMITED,

A Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation;

By /s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

UNITED STATES OF AMERICA,

By /s/ LOUIS B. BLISSARD,
United States Attorney, District of Hawaii; Attorney for Defendant.

EXHIBIT No. 1

Before the Public Utilities Commission
of the Territory of Hawaii

Docket No. 1108

In the Matter of the Application of

HILO GAS COMPANY, LIMITED, for Authority to Sell Its Utility Assets.

Order No. 708

This matter came before the Commission upon application of Hilo Gas Company, Limited, hereinafter referred to as the "Company" or "Applicant," filed October 20, 1950, wherein Applicant requests authority to sell its utility assets, including its franchise, to Honolulu Gas Company, Limited.

The application was before the Commission at a hearing held on October 26, 1950. J. Garner Anthony, Esq., of the firm of Robertson, Castle and Anthony, appeared for the Applicant; Michiro Watanabe, Esq., Assistant Attorney General, appeared for the Commission.

The Company presented its case consisting of its application and the testimony of three witnesses[1]. The Commission's staff did not submit a report in the matter as it had received the application only six days prior to the hearing; however, the staff advised the Commission of its full knowledge of all matters related to the application and recommended approval thereof.

Applicant proposes to sell, assign, transfer and convey to Honolulu Gas Company, Limited, for a total consideration of approximately $64,000, all of its utility assets, including its franchise, but excluding its non-utility assets, which consist of merchandise, goods, notes and accounts receivable related to its appliance sales business and liquefied petroleum gas business.

The record shows that the Honolulu Gas Company, Limited, has agreed to purchase the utility assets of Applicant on the terms set forth hereinabove, upon approval of the Company's application by this Commission. The record further shows that the present gas manufacturing plant of Applicant is obsolete, that its production costs are high, that the cost of a new manufacturing gas plant is prohibitive, and that the Honolulu Gas Company, Limited, upon approval of the proposed sale and acquisition, plans to abandon Applicant's present gas manufacturing plant and to employ its distribution system in distributing a butane-air gas, as soon as

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[1]A. E. Englebright, K. A. Conningham, L. L. Gowans.

the necessary work of conversion can be accomplished.

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that the proposed sale of Applicant's utility assets to the Honolulu Gas Company, Limited, is in the public interest. It also appears in the public interest that the proposed sale be consummated at the earliest possible date. The Commission will, therefore, authorize Applicant to sell its utility assets to the Honolulu Gas Company, Limited, immediately.

Now, therefore, it is hereby

Ordered: That Applicant be and it is hereby authorized to sell, assign, transfer and convey all of its utility assets, including its franchise, to the Honolulu Gas Company, Limited, for a total consideration of approximately $64,000, consisting of a cash payment of approximately $46,000 for its utility assets and the assumption by the purchaser of outstanding utility liabilities in the amount of approximately $18,000.

Done at Honolulu, City and County of Honolulu, Territory of Hawaii, this 26th day of October, 1950.

PUBLIC UTILITIES COMMISSION OF THE TERRITORY OF HAWAII,

By /s/ J. H. HUGHES,
Acting Chairman;

By /s/ LEO G. LYCURGUS,
Commissioner;

By /s/ J. M. O'DOWDA,
Commissioner;

By /s/ F. G. MANARY,
Commissioner;

By /s/ A. C. BAPTISTE, JR.,
Commissioner.

Attest:

I, Jean Kenny Bradford, Executive Secretary of the Public Utilities Commission of the Territory of Hawaii, do hereby certify that the foregoing Order No. 708 is a full, true and complete copy of original on file in the office of the Commission.

/s/ JEAN KENNY BRADFORD,
Secretary.

[Endorsed]: Filed November 15, 1950, Public Utilities Commission, T. H.

File Number

ANNUAL CORPORATION EXHIBIT

OF

HILO GAS COMPANY, LIMITED

P. O. Box 1960, Honolulu, Hawaii
(Mailing Address)

For the Fiscal Period Ended December 31, 1951

Date of Incorporation July 21, 1916

Authorized Capital:

Class	Shares	Par Share	Par Total
Pfd. 8% Cum.	3,000	$ 20.00	$ 60,000.00
Pfd. 7%	2,000	$ 20.00	$ 40,000.00
Common	5,500	$ 20.00	$ 110,000.00
		$	$

Paid In Capital:

Class	Shares	Amount
Pfd. 8% Cum.	2,283	$ 45,660.00
Pfd. 7%	1,929	$ 38,580.00
		$
		$

FILING FEE OF $10.00
Paid on:

Form prescribed
WILLIAM B. BROWN
Treasurer of the Territory of Hawaii

Form approved January 29, 1947
INGRAM M. STAINBACK
[illegible]

Nature of corporate business: Manufacturing & distribution of gas

Officers and directors as of December 31, 1951:

Office Held	Name in Full	Residence Address
President	Everett E. Black	2020 Mott-Smith Dr., Honolulu
Vice-president	A. Eugene Englebright	3039 Gail, Honolulu
Secretary-treasurer	John C. Rosebrook	3111 Diamond Hea. Rd., Honolulu
*Directors:	Everett E. Black	2020 Mott-Smith Dr., Honolulu
	A. Eugene Englebright	3039 Gail, Honolulu
	Chauncey B. Wightman	3137 Oahu Ave., Honolulu
	Cyril F. Damon	2920 Nuuanu Ave., Honolulu
	J. Howard Worrall	65 Dowsett Ave., Honolulu

*Majority of whom must be residents of the Territory of Hawaii

DECLARATION

I declare under the penalties set forth in Section 8446, Revised Laws of Hawaii 1945, as amended, that this exhibit including any accompanying schedules or statements, has been examined by me, and to the best of my knowledge and belief is a true, correct, and complete exhibit, made in good faith, for the fiscal period stated. This exhibit must be filed and the filing fee of $10.00 paid to the Treasurer within ninety days immediately following the close of the calendar year or fiscal year, depending upon the year basis adopted.

(Signature of person or firm preparing this exhibit) (Signature of authorized corporate officer)

SPECIAL INSTRUCTIONS

All of the information requested in this exhibit must be furnished. Failure to do so will make this exhibit not acceptable. To file this exhibit on other than a calendar year basis, permission must first be obtained from the Treasurer of the Territory of Hawaii.

EXHIBIT 2

72

51

ANNUAL CORPORATIC [illegible] XHIBIT OF HILO GAS COMPANY, LIMITED

COMPARATIVE GENERAL BALANCE SHEET

ITEMS	Beginning of Period Detail	Beginning of Period Total	End of Period Detail	End of Period Total
ASSETS				
Current				
Cash on hand and in bank		14,498.75		7,549.6[illegible]
Accounts receivable	531.50		2,498.07	
Less reserve for bad debts		531.50		2,498.[illegible]
Notes receivable		50,000.00		50,000.[illegible]
Inventories				
Finished goods				
Raw materials and supplies		904.60		631.26
Merchandise in transit				
Investments				
Stocks—Local				
—Mainland				
Bonds—U. S. government				
—State, municipal				
—All other				
Fixed				
Land				
Leasehold				
Buildings				
Machinery and equipment				
Furniture and fixtures				
Delivery equipment				
Total			3,843.85	
Less reserve for depreciation			689.60	3,154.25
Prepaid expenses				
Unexpired insurance				505.83
Interest				
Other assets				
Total assets		65,934.65		64,[illegible]
LIABILITIES AND CAPITAL				
Current				
Accounts payable				
Notes payable		4,498.50		1,933.75
Accrued expenses				
Payroll				
Interest				
Income tax				
Other taxes				
Fixed				
Mortgage payable				
Bonds payable				
Deferred credits				
Capital				
Preferred stock issued				
Common stock issued	84,240.00		84,240.00	
Surplus reserves				
Capital surplus				
Earned surplus (or deficit)	(22,805.85)		(21,834.65)	
Total		61,434.15		62,405.35
Less treasury stock at cost—Preferred				
—Common				
Total liabilities and capital		65,934.65		64,[illegible]

EXHIBIT 2

FOR THE FISC[illegible]OD ENDED December 31, [illegible]

COMPARATIVE STATEMENT OF INCOME AND SURPLUS

ITEMS	Last Preceding Period Detail	Last Preceding Period Total	Current Period Detail	Current Period Total
[illegible]ales (where inventories are used)		28,171.17		[illegible]
[illegible] at beginning of period	5,661.93		904.60	
[illegible]dise purchased or manufactured	25,500.09		616.61	
Total	31,162.02		1,521.21	
[illegible] inventory at end of period	904.60		631.26	
[illegible] goods sold		30,257.42		889.9[illegible]
[illegible] profit on sales (Loss)		(2,086.25)		528.5[illegible]
[illegible] revenues (where inventories are not used)	158,018.27		63,566.05	
[illegible] cost of operation	122,739.96	35,278.31	55,200.44	8,365.6[illegible]
[illegible] profit		33,192.06		8,89[illegible]
[illegible] other income				
Interest	392.43		500.00	
[illegible]dends				
Rents			9,900.[illegible]	
Sundry	5.00			
		397.43		10,4[illegible]
[illegible] income		33,589.49		19,[illegible]
[illegible] expenses				
[illegible] salaries			100.[illegible]	
Other salaries and wages			5,12[illegible]	
[illegible]eciation	10,600.22		689.6[illegible]	
[illegible]dends	1,800.00			
[illegible]erest	714.38			
[illegible] other than income	12,862.88		3,4[illegible]	
Rent	2,500.00		6,[illegible]	
Other	75.00		2,596.17	
Loss on sale of property	122,830.58			
		151,382.06		18,324.[illegible]
Net income (or loss) before income taxes		(117,792.57)		967.[illegible]
[illegible] income taxes				
Net income (or loss) transferred to surplus		(117,792.57)		967.[illegible]
[illegible] surplus at beginning of period		94,988.72		
[illegible] credits to surplus (detail)				
Total		(22,803.85)		7[illegible]
[illegible] at beginning of period				22,[illegible]
[illegible] to surplus (detail)				
[illegible] (or deficit) at end of period		(22,803.85)		[illegible]

[illegible] STOCK

[illegible] during the fiscal period	([illegible]	shares preferred stock at $ [illegible] par value
	([illegible]	shares common stock at $ [illegible]
[illegible] received for stock issued during the fiscal period	($	cash
	($	value of property
	($	value of services
[illegible] during the fiscal period	(	shares preferred stock
	(	shares common stock
[illegible]	($	cash
	(Other manner	
[illegible] stock reacquired during the fiscal period	(	shares preferred stock
	(	shares common stock
[illegible] received for stock [illegible] during the fiscal period	($	cash
	($	value of property
	($	value of services

[illegible]NDED DEBT

[illegible] during the fiscal period	($	par value
Consideration received for bonds [illegible] during the fiscal period	($	cash
	($	value of property
	($	value of services

EXHIBIT 2

VOTING POWERS AND STOCKHOLDERS

Yes

No

2,222

21

Name In Full	Mailing Address	Shares	Par Value
	8% Preferred - Cum.		
[illegible] Chow	614 Kilauea Ave., Hilo, Hawaii	1	
[illegible] Chong	Inter-Island Drug Co., Lahaina	1	
[illegible]acific Refiners, Ltd.	75 S. King St., Honolulu	2,281	[illegible]
	Total 8% Preferred		[illegible]
	7% Preferred		
[illegible] Sam Ching	c/o George Tung, 76 Derby, Hilo	5	[illegible]
[illegible]oung Kong Yee	1973 Kanoa St., Hilo	2	[illegible]
[illegible] Silv.	c/o Mrs. Caroline Silva, Huntington Park, Calif.	5	[illegible]
[illegible] Kitagawa	I. Kitagawa & Co., Hilo	5	[illegible]
[illegible]arles Ah Nui	151 Panaewa St., Hilo	2	[illegible]
[illegible] Hillfong	Hilo, Hawaii	5	[illegible]
[illegible] Chow	614 Kilauea Ave., Hilo	10	[illegible]
[illegible]ank Lopes deSilva	Laupahoehoe, Hawaii	3	[illegible]
[illegible]cilia [illegible] Canaria	Makalea, Hawaii	2	[illegible]
[illegible]ock Chong	Inter-Island Drug Co., Lahaina	6	[illegible]
[illegible]ry West, Gdn. of Marie West	1025 Koko Head Ave., Honolulu	2	[illegible]
[illegible] Young	98 Prospect St., Honolulu	5	[illegible]
[illegible] Carvalho	394 Haili St., Hilo	5	[illegible]
[illegible]rlos Carvalho	394 Haili St., Hilo	5	[illegible]
[illegible] Refiners, Ltd.	75 S. King St., Honolulu	1,857	4
[illegible] Black	2020 Mott-Smith Dr., Honolulu	1	20
[illegible] Applebright	3039 Gail, Honolulu	1	20
[illegible]	2920 Kuakini Ave., Honolulu	1	20
[illegible]ightman	3137 Oahu Ave., Honolulu	1	20
[illegible], Trustee for [illegible] & Alice Fukushima	McCandless Bldg., Honolulu	5	100
[illegible] Howard Worrall	65 Dowsett Ave., Honolulu	1	20
			0.

EXHIBIT 2

File Number

ANNUAL CORPORATION EXHIBIT

OF

HILO GAS COMPANY, LIMITED

P. O. Box 1900, Honolulu, Hawaii
(Mailing Address)

For the Year Ended December 31, 1952

Date of Incorporation July 21, 1916

Authorized Capital

Class	Shares	Par Share	Par Total
Pfd. 6% Cum.	3,000	$ 20.00	$ [illegible]
Pfd. 7%	2,000	$ 20.00	$ [illegible]
Common	5,500	$ 20.00	$ [illegible]
		$	$

Paid-In Capital:

Class	Shares	Amount
Pfd. 6% Cum.	2,203	$ [illegible]
Pfd. 7%	1,929	$ 38,5[illegible]
		$
		$

Filing fee of $10.00 paid on

Nature of corporate business Manufacturing and Distributing of Gas

Officers and directors as of December 31, 1952

HILO GAS COMPANY

DIRECTORS

E. E. Black
President, E. E. Black, Ltd.
1067 Kawaiahao

A. E. Englebright
Vice President and General Manager
Honolulu Gas Company, Ltd.
75 S. King Street

C. F. Damon
President, Bishop Trust Company, Ltd.
141 S. King Street

C. B. Wightman
Vice President, Alexander & Baldwin, Ltd.
822 Bishop Street

J. Howard Worrall
President, H. G. M. B.
1534 Kapiolani Blvd.

OFFICERS

E. E. Black, President

A. E. Englebright, Vice President

J. C. Rosebrook, Secretary-Treasurer
Honolulu Gas Company, Ltd.
75 S. King Street

SPECIAL INSTRUCTIONS

All of the information requested in this exhibit must be furnished. Failure to do so will make this exhibit not acceptable. To file this exhibit on other than a calendar year basis, permission must first be obtained from the Treasurer of the Territory of Hawaii. This exhibit must be filed, and the filing fee of $10.00 paid to the Treasurer within NINETY DAYS immediately following the close of the year basis adopted. Failure to file will subject the corporation to a maximum penalty of $100.00 for every thirty days continuance, and if continued for a period of two years will further subject the corporation to dissolution by the Treasurer.

EXHIBIT 2

ANNUAL CORPORATI[illegible] EXHIBIT OF [illegible]

COMPARATIVE GENERAL BALANCE SHEET

ITEMS	Beginning of Period Detail	Beginning of Period Total	End of Period Detail	End of Period Total
ASSETS				
Current				
Cash on hand and in bank		[illegible]		
Accounts receivable	[illegible]	[illegible]	[illegible]	
Less reserve for bad debts		[illegible]		
Notes receivable		50,000.00		
Inventories				
Finished goods				
Raw materials and supplies		631.[illegible]		
Merchandise in transit				
Investments				
Stocks—Local				
—Mainland				
Bonds—U. S. government				
—State, municipal				
—All other				
Fixed				
Land				
Leasehold				
Buildings	3,708.85			
Machinery and equipment				
Furniture and fixtures	135.00		[illegible]	
Delivery equipment				
Total	3,843.85		[illegible]	
Less reserve for depreciation	689.60	3,154.25	[illegible]	
Prepaid expenses		505.89		
Unexpired insurance				
Interest				
Other assets				
Capital stock subscription				
Total assets		64,339.09		
LIABILITIES AND CAPITAL				
Current				
Accounts payable		1,933.74		[illegible]
Notes payable				
Accrued expenses				
Payroll				
Interest				
Income taxes				
Other taxes				[illegible]
Fixed				
Mortgage payable				
Bonds payable				
Deferred credits				
Capital				
Preferred stock issued	84,240.00		84,240.[illegible]	
Common stock issued				
Surplus reserves				
Capital surplus				
Earned surplus (or deficit)	(21,834.65)	62,405.35	[illegible]	[illegible]
Total				
Less treasury stock at cost—Preferred				
—Common				
Total liabilities and capital		64,339.09		[illegible]

EXHIBIT 2

FOR THE [illegible] ENDED December 31, 19[illegible]

COMPARATIVE STATEMENT OF INCOME AND SURPLUS

ITEMS	Last Preceding Period Detail	Last Preceding Period Total	Current Period Detail	Current Period Total
Net sales (where inventories are used)		[illegible]		161.[illegible]
Inventory at beginning of period	[illegible]			
Merchandise purchased or manufactured	[illegible]			
Total	[illegible]			
Less inventory at end of period	[illegible]			
Cost of goods sold		[illegible]		
Gross profit on sales		[illegible]		168.23
				([illegible].76)
Gross revenues (where inventories are not used)	[illegible]			
Less cost of operation	[illegible]	[illegible]		
Gross profit		[illegible]		
Add other income				
Interest				
Dividends		500.00		500.00
Rents		9,900.00		10,237.50
Total income		19,[illegible].16		10,73[illegible].75
Less expenses				
Officers' salaries	100.00		300.00	
Other salaries and wages	5,1[illegible].83			
Depreciation	689.60		575.59	
Bad debts				
Interest				
Taxes other than income	1,[illegible].67		685.85	
Rent	6,339.[illegible]		5,461.68	
Other	2,[illegible].37		3,250.14	
Net income (or loss) before income taxes		18,3[illegible].96		10,273.[illegible]
Income taxes		969.20		459.50
Net income (or loss) transferred to surplus		969.20		459.50
Surplus at beginning of period				
Add credits to surplus (detail)				
Total		969.20		459.[illegible]
Deficit at beginning of period		([illegible],803.85)		(21,834.[illegible])
Less debits to surplus (detail)				
Surplus (or deficit) at end of period		(21,834.65)		(21,375.[illegible])

CAPITAL STOCK:

Issued during the period (______ shares preferred stock at $______ par value
(______ shares common stock at $______ par value

Consideration received for stock issued during the period
($______ cash
($______ value of property
($______ value of services

Acquired during the period
(______ shares preferred stock
(______ shares common stock

How acquired
($______ cash
(Other manner:______

Acquired stock reissued during the period
(______ shares preferred stock
(______ shares common stock

Consideration received for stock reissued during the period
($______ cash
($______ value of property
($______ value of services

BONDED DEBT:

Issued during the period ($______ par value

Consideration received for bonds issued during the period
($______ cash
($______ value of property
($______ value of services

EXHIBIT 2

VOTING POWERS AND STOCKHOLDERS

(a) Does each share of stock have the right to vote? Yes If not, explain voting rights

(b) Has any class of stock or securities any special privileges in the election of directors, trustees, or other man[illegible] personnel, or in the determination of any corporate action? No If so, give details

(c) State the total voting power of all stockholders as of the date of this report. 4,212

(d) State the total number of stockholders as of the date of this report. 21

(e) In the space below, or on sheets attached thereto and in accordance with the column headings indicated, [illegible] stockholders by each class of stock. If the stock is held by a Trustee, make a full disclosure of the names, a[illegible] and shares of the equitable owners. If the stock is without par value, then state the subscription price, the total [illegible] on account of the subscription, and furnish a statement showing the total consideration received from the sale [illegible] distributed as to capital [illegible] paid-in surplus.

Name in Full		Mailing Address	Total Subscription		T[illegible]
			Shares	Par Value	At [illegible]

HILO GAS COMPANY

LIST OF STOCKHOLDERS

As of December 31, 1952

FIRST PREFERRED - 8%

Cert. No.	Name of Stockholder	Address	No. Shares		
68	Chock Chong	Inter-Island Drug Co., Lahaina		1	$ 20.00
77	Pacific Refiners, Ltd.	75 S. King St., Honolulu	2,282	(1,750	
78	" " "	" " "		(523	45,640.00
79	" " "	" " "		(9	
		Total		2,283	45,660.00

SECOND PREFERRED - 7%

Cert. No.	Name of Stockholder	Address	No. Shares	
20	T. Sam Ching (deceased)	c/o Geo. Tung, 76 Derby, Hilo	5	100.00
21	Young Kang Yee	c/o Hawaii Egg Noodle Mfg.Co., Hilo	2	40.00
30	I. Kitagawa	I. Kitagawa & Co., Hilo	5	100.00
31	Charles Ah Hui	151 Punaova St., Hilo	2	40.00
33	H. C. Willfong(dec'd)	Hilo, Hawaii	5	100.00
66	Frank Lopes De Silva	Laupahoehoe, Hawaii	2	40.00
68	Cecelia K. Cavario	Hakalau, Hawaii	2	40.00
69	Chock Chong	Inter-Island Drug Co., Lahaina	6	120.00
82	Frank Lopes Silva	Laupahoehoe, Hawaii	1	20.00
83	Henry West, Guardian	1026 Koko Head Ave., Honolulu	2	40.00
96	K. Y. Young Hu	985 Prospect St., Honolulu	5	100.00
214	Urban C. Carvalho	394 Haili St., Hilo	5	100.00
215	Carlos C. Carvalho	394 Haili St., Hilo	5	100.00
235	Pacific Refiners, Ltd.	75 S. King St., Honolulu	1,867	37,340.00
236	E. E. Black	1067 Kawaiahao, Honolulu	1	20.00
237	A. E. Englebright	75 S. King St., Honolulu	1	20.00
239	Cyril Damon	Bishop Trust Co., 141 S. King St., Honolulu	1	20.00
240	Chauncey B. Wightman	Alexander & Baldwin, 822 Bishop St., Honolulu	1	20.00
241	Peter Lee, Trustee	(Unknown)	5	100.00
242	M. A. Silva (Dec'd)	c/o Caroline Silva, Huntington Park, Calif.	5	100.00
243	J. Howard Worral	K.G.M.B., 1534 Kapiolani Blvd., Honolulu	1	20.00
		Total	1,929	$38,58[illegible]

EXHIBIT 2

58 7[illegible]

ANNUAL CORPORATION EXHIBIT

OF

HILO [illegible] COMPANY, LIMITED

P. O. Box [illegible], Honolulu, Hawaii

(Mailing Address)

For the Year Ended December 31, 1953

Date of Incorporation August 21, 1910

Authorized Capital:

Class	Shares	Par Share	Par Total
Pfd. 6% Cum.	3,000	20.00	[illegible]
Pfd. [illegible]	2,000	20.00	[illegible]
Common	[illegible]	20.00	[illegible]

Paid In Capital:

Class	Shares	Amount
Pfd. 6% Cum.	2,283	[illegible]
Pfd. 7%	1,969	[illegible]

Filing fee of $10.00 paid on

[illegible]ature of corporate business: Rental and sundry services

Officers and directors as of December 31, 1953:

Office Held	Name in Full	Residence Address

HILO [illegible] COMPANY, LIMITED

[illegible]

[illegible]	[illegible] Mott-Smith Drive	Honolulu
A. F. Englebright	[illegible] Oahu	"
C. F. Damon	2920 Nuuanu Ave.	"
[illegible] B. [illegible]ightman	3137 Oahu Ave.	"
J. Howard Worrall	2130 Puualii Place	"

[illegible]

[illegible]. E. Black, President	[illegible] Mott-Smith Drive	Honolulu
A. F. Englebright, Vice President	[illegible]	"
J. [illegible]. Rosebrook, [illegible]retary-Treasurer	[illegible] Drive	"

(Signature of person or firm preparing this exhibit)

(Signature of authorized corporate officer)

Date

Office held

SPECIAL INSTRUCTIONS

All of the information requested in this exhibit must be furnished. Failure to do so will [illegible]

To file this exhibit on other than a calendar year basis permission must first be obtained from the [illegible] [illegible]ritory of Hawaii. This exhibit must be filed, and the filing fee of $10.00 paid to the Trea[illegible] [illegible]diately following the close of the year basis adopted. Failure to file will subject the corporati[illegible] [illegible] for every thirty days continuance, and if continued for a period of two years will furth[illegible] [illegible]solution by the Treasurer.

EXHIBIT 2

ANNUAL CORPORATION EXHIBIT OF [illegible]

COMPARATIVE GENERAL BALANCE SHEET

ITEMS	Beginning of Period Detail	Beginning of Period Total	End of Period Detail	End of Period Total
ASSETS				
Current				
Cash on hand and in bank		8,5[illegible]		[illegible]
Accounts receivable	4,216.59		[illegible]	
Less reserve for bad debts				
Notes receivable		4,216.59		[illegible]
Inventories		50,000.00		[illegible]
Finished goods				
Raw materials and supplies				
Merchandise in transit				
Investments				
Stocks—Local				
—Mainland				
Bonds—U. S. government				
—State, municipal				
—All other				
Fixed				
Land				
Leasehold				
Buildings				
Machinery and equipment	135.00		135.0[illegible]	
Furniture and fixtures				
Delivery equipment				
Total	135.00		135.[illegible]	
Less reserve for depreciation	28.94	106.06	[illegible]	[illegible]
Prepaid expenses		137.50		[illegible]
Unexpired insurance				
Interest				
Other assets				
Capital stock subscription				
Total assets		63,037.67		[illegible]
LIABILITIES AND CAPITAL				
Current				
Accounts payable		138.04		[illegible]
Notes payable				
Accrued expenses				
Payroll				
Interest				
Income taxes				[illegible]
Other taxes		34.78		[illegible]
Fixed				
Mortgage payable				
Bonds payable				
Deferred credits				
Capital				
Preferred stock issued	84,240.00		[illegible]	
Common stock issued				
Surplus reserves				
Capital surplus				
Earned surplus (or deficit)	(21,375.15)	62,864.85	[illegible]	[illegible]
Total				
Less treasury stock at cost—Preferred				
—Common				
Total liabilities and capital		63,037.67		[illegible]

EXHIBIT 2

FOR THE [illegible] ENDED [illegible]

COMPARATIVE STATEMENT OF INCOME AND SURPLUS

ITEMS	Last Preceding Period Detail	Last Preceding Period Total	Current Period Detail	Current Period Total
[illegible] ales (where inventories are used)		[illegible]		
[illegible] entory at beginning of period				
[illegible] handise purchased or manufactured				
Total				
[illegible] inventory at end of period				
[illegible] of goods sold		146.23		
[illegible] ss profit on sales		(4.74)		
[illegible] revenues (where inventories are not used)				
[illegible] cost of operation				
[illegible] ss profit		(4.74)		
Add other income				
Interest		500.00		[illegible]
Dividends				
[illegible] ents		10,237.50		[illegible]
Total income		10,732.76		[illegible]
Less expenses				
Officers' salaries	300.00			
Other salaries and wages				
Depreciation	575.59		[illegible]	
[illegible] debts				
Interest				
[illegible] other than income	685.85		[illegible]	
[illegible]	5,461.68		3,[illegible]	
[illegible]	3,250.14		[illegible]	
		10,273.26		
Net income (or loss) before income taxes		459.50		[illegible]
Income taxes				
Net income (or loss) transferred to surplus		459.50		[illegible]
Surplus at beginning of period				
Add credits to surplus (detail)				
Total		459.50		[illegible]
[illegible] eficit at beginning of period		(21,834.65)		[illegible]
[illegible] debits to surplus (detail)				
[illegible] Territorial income tax				[illegible]
Surplus (or deficit) at end of period		(21,375.15)		[illegible]

CAPITAL STOCK

Issued during the period (______ shares preferred stock at $______ par value
(______ shares common stock at $______ par value

Consideration received for stock issued during the period ($______ cash
($______ value of property
($______ value of services

Acquired during the period (______ shares preferred stock
(______ shares common stock

How acquired ($______ cash
(Other manner: ______

Acquired stock reissued during the period (______ shares preferred stock
(______ shares common stock

Consideration received for stock reissued during the period ($______ cash
($______ value of property
($______ value of services

BONDED DEBT:

Issued during the period ($______ par value

Consideration received for bonds issued during the period ($______ cash
($______ value of property
($______ value of services

EXHIBIT 2

TING POWERS AND STOCKH... RS

(a) Does each share of stock have the right to vote? ______ If not, explain voting rights ______

(b) Has any class of stock or securities any special privileges in the election of directors, trustees, or other manageme... personnel, or in the determination of any corporate action? ______ If so, give details ______

(c) State the total voting power of all stockholders as of the date of this report. ______

(d) State the total number of stockholders as of the date of this report. ______

(e) In the space below, or on sheets attached thereto and in accordance with the column headings indicated list a... stockholders by each class of stock. If the stock is held by a Trustee, make a full disclosure of the names, addresse... and shares of the equitable owners. If the stock is without par value, then state the subscription price, the total paid i... on account of the subscription, and furnish a statement showing the total consideration received from the sale of stoc... distributed as to capital and as to paid-in surplus.

HILO GAS COMPANY

LIST OF STOCKHOLDERS

As of December 31, 1953

FIRST PREFERRED - 8%

Cert. No.	Name of Stockholder	Address	No. Shares	
68	Cheek Chung	Inter-Island Drug Co., Lahaina	1	$ 20.00
77	Pacific Refiners, Ltd.	75 S. King St., Honolulu	2,282 (1,750.	
78	" " "	" " "	523	45,640.00
79	" " "	" " "	(	
		Total	2,283	45,660.00

SECOND PREFERRED - 7%

Cert. No.	Name of Stockholder	Address	No. Shares	
20	T. Sam Ching (deceased)	c/o Geo. Tung, 76 Derby, Hilo	5	100.00
21	Young Kang Yee	c/o Hawaii Egg Noodle Mfg.Co., Hilo	2	40.00
30	I. Kitagawa	I. Kitagawa & Co., Hilo	5	100.00
31	Charles Ah Hui	151 Punaeva St., Hilo	2	40.00
33	H. C. Willfong(dec'd)	Hilo, Hawaii	5	100.00
66	Frank Lopes De Silva	Laupahoehoe, Hawaii	2	40.00
68	Cecelia K. Cavario	Hakalau, Hawaii	2	40.00
69	Cheek Chung	Inter-Island Drug Co., Lahaina	6	120.00
82	Frank Lopes Silva	Laupahoehoe, Hawaii	1	20.00
83	Henry West, Guardian	1026 Koko Head Ave., Honolulu	2	40.00
96	H. I. Young Ho	963 Prospect St., Honolulu	5	100.00
214	Urban C. Carvalho	394 Haili St., Hilo	5	100.00
215	Carlos G. Carvalho	394 Haili St., Hilo	5	100.00
235	Pacific Refiners, Ltd.	75 S. King St., Honolulu	1,867	37,340.00
236	E. E. Black	1067 Kawaiahao, Honolulu	1	20.00
237	A. E. Englebright	75 S. King St., Honolulu	1	20.00
239	Cyril Damon	Bishop Trust Co., 141 S. King St., Honolulu	1	20.00
240	Chauncey B. Wightman	Alexander & Baldwin, 822 Bishop St., Honolulu	1	20.00
241	Peter Lee, Trustee	(Unknown)	5	100.00
242	M. A. Silva (Dec'd)	c/o Carolina Silva, Huntington Park, Calif.	5	100.00
243	J. Howard Worral	K.G.M.B., 1534 Kapiolani Blvd., Honolulu	1	20.00
		Total	1,929	$38,580.00

[Endorsed]: Filed December 1, 1958.

EXHIBIT 2

[Title of District Court and Cause.]

STIPULATION WITH RESPECT TO QUESTIONS OF LAW

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys that the following are the questions of law raised in this case, upon which the parties are in disagreement, and that these are the only questions of law involved:

First Issue

Can the net operating loss suffered by Hilo Gas Company, Limited, in 1950 be carried forward by its parent, Pacific Refiners, Limited, on a consolidated return basis to the year 1953?

The position of the taxpayer is that, under the plain terms of the statute (Sec. 141, Internal Revenue Code of 1939) and the Consolidated Return Regulations, Pacific Refiners, Limited, is entitled to carry forward the Hilo Gas 1950 loss as a consolidated net operating loss to 1953; that there was a sound business purpose for the acquisition of control of Hilo Gas by Pacific Refiners and that there was no tax evasion or avoidance purpose.

The position of the government is that the carry forward can be denied because the "principal purpose" of the acquisition of control of Hilo Gas was tax evasion or avoidance within the meaning of Section 129 of the Internal Revenue Code of 1939 or because there was no "business purpose" for the acquisition or because there was no "economic loss" to the parent corporation.

Second Issue

Can Pacific Refiners, Limited, deduct in the year of its liquidation expenses of selling its capital stock?

The taxpayer's position is that these expenses are deductible in the year of complete liquidation.

The government's position is that these expenses are not deductible in any year.

Third Issue

Can Pacific Refiners, Limited, deduct in 1955 Territory of Hawaii income taxes allocable to gain from the sale of its properties realized in 1955 but not recognized for federal income tax purposes by reason of Section 337 of the Internal Revenue Code of 1954?

The taxpayer's position is that the Hawaii income taxes are deductible under Section 164(a) of the Internal Revenue Code of 1954 and that Section 265 of the Internal Revenue Code of 1954 is not applicable.

The government's position is that Section 265 is applicable, and that for this reason the deduction for Territorial taxes was correctly disallowed.

Dated: Honolulu, Hawaii, September 2, 1959.

HAWAIIAN TRUST
COMPANY, LIMITED,
A Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation;

By /s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

UNITED STATES OF
AMERICA,

By /s/ LOUIS B. BLISSARD,
United States Attorney, District of Hawaii; Attorney for Defendant.

Filed: September 2, 1959.

[Endorsed]: Filed September 2, 1959.

[Title of District Court and Cause.]

OPINION AND JUDGMENT

While counsel for the plaintiff has shown considerable industry and ingenuity in presenting his arguments, that industry and that ingenuity have not availed to counterbalance the essentially tenuous character of his reasoning.

In contrast, the defendant's position is simple, clear, and based upon elementary logic, as well as being supported by statute law and the applicable Treasury Regulations.

1. Statement of the Case.

The plaintiff seeks recovery of $109,692.18, representing the principal amount of income taxes alleged to have been illegally and erroneously assessed and collected for 1953 and 1955, plus interest paid thereon, amounting to $15,055.76, or a total of $124,747.94. In addition, the plaintiff claims that it is entitled to interest on the entire amount of principal and interest paid. In other words, there is presented the familiar problem of "interest on interest."

The amounts of the alleged overassessments and overpayments are claimed by the plaintiff to be as follows:

Year	Principal	Interest	Total
1953	$ 58,472.39	$11,309.99	$ 69,774.38
1955	51,219.79	3,753.77	54,973.56
	$109,692.18	$15,055.76	$124,747.94

The parties have stipulated that three issues are presented in this case, as follows:

I.

Can the net operating loss suffered by Hilo Gas Company, Limited, hereinafter Hilo Gas, in 1950 be carried forward by its parent, Pacific Refiners, Limited, hereinafter Refiners, on a consolidated return basis to 1953?

The plaintiff's position is that, under the plain terms of the statute ((Section 141, Internal Revenue Code (hereinafter sometimes the Code) of 1939)) and the Consolidated Return Regulations, Refiners is entitled to carry forward the Hilo Gas 1950 loss as a consolidated net operating loss to 1953. It is contended that there was a sound business purpose for the acquisition of control of Hilo Gas by Refiners and that there was no tax evasion or avoidance purpose.

The position of the defendant is that the carry-forward can be denied because the "principal purpose" of the acquisition of control of Hilo Gas was tax evasion or avoidance within the meaning of Section 129 of the Code of 1939, or because there was no "business purpose" for the acquisition or because there was no "economic loss" to the parent corporation.

II.

Can Refiners deduct in the year of its liquidation expenses of selling its capital stock?

The plaintiff's position is that these expenses are deductible in the year of complete liquidation.

The defendant contends that these expenses are not deductible in any year.

III.

Can Refiners deduct in 1955 Territory of Hawaii income taxes allocable to gain from the sale of its properties realized in 1955 but not recognized for Federal income tax purposes by reason of Section 337 of the Internal Revenue Code of 1954?

The plaintiff maintains that the Hawaii income taxes are deductible under Section 164(a) of the Internal Revenue Code of 1954 and that Section 265 of that Code is not applicable.

The defendant insists that Section 265 is applicable, and that for this reason the deduction for Territorial taxes was correctly disallowed.

2. Stipulation of Facts.

The case was submitted to the Court on a stipulation of facts. Sharply abridged, that stipulation is as follows:

Refiners was organized as a corporation under the laws of Hawaii in 1949. It was dissolved on November 19, 1956, and the plaintiff was appointed Trustee for the creditors and the stockholders.

Refiners had an initial authorized capital of $250,000, represented by 250,000 shares of common stock of the par value of $1 each. Honolulu Gas Company, Limited, hereinafter Honolulu Gas, purchased at par the initial 250,000 shares of common stock of Refiners, and in 1949 distributed such stock as a dividend to the stockholders of Honolulu Gas.

After its organization, Refiners engaged in the merchandising of gas appliances, and commenced the construction of its refinery. To pay for that construction work, it borrowed $650,000 on short-term promissory notes. In May, 1950, Refiners sold to the public an additional 500,000 shares of common stock and $750,000 worth of 15-year, 6%, sinking fund debentures. The net proceeds of this issue were estimated at $1,225,445. In connection with this offering, Refiners incurred expenditures attributable to the issuance of its shares of common stock in the amount of $9,259.74.

In December, 1950, Refiners completed the construction of its refinery.

In April, 1951, Refiners sold an additional 750,000 shares of common stock to the public. The net proceeds from this issue were estimated at $734,400. In connection with this issue, Refiners incurred capital stock expenses of $21,418.88.

Refiners' principal business was the manufacture and sale of petroleum products and the distribution of butane—a form of liquefied petroleum gas—in Hawaii. The corporation was not a public utility, and none of its business was subject to regulation by the Public Utilities Commission of Hawaii, hereinafter the Commission.

Refiners entered into an oil and butane contract with Standard Oil of California, hereinafter Standard, in 1949, for a period of ten years for the purchase of petroleum and butane. The Hilo Gas Company, Limited, hereinafter Hilo Gas, after its conversion to butane air in 1951, used more than 500,000 gallons of butane annually, accounting for about one-third of the total butane sales of Refiners.

Hilo Gas was organized as a corporation in Hawaii in 1927. It manufactured gas from oil and distributed it through gas mains in Hilo, and was a public utility subject to regulation by the Commission.

In 1948-1949, Hilo Gas was in financial difficulty. In 1950, A. E. Englebright, who was then the general manager of Refiners, was approached by Orlando Lyman, the president and largest stockholder of Hilo Gas, for assistance in solving the problems of the latter company.

The proposition was made that Hilo Gas cease the manufacture of gas from oil and buy butane from Refiners, which Hilo Gas would then distribute through its gas mains in Hilo as a public utility. This would save manufacturing costs and reduce gas rates to a point where they might be competitive with electric rates.

The feasibility of the Hilo Gas plan depended to some extent on the condition of its gas mains. Englebright sent L. L. Gowans, chief engineer of Honolulu Gas, to Hilo to make a survey. Gowans reported that the gas mains were in adequate condition, and that it would be entirely feasible to distribute butane air mix in the Hilo Gas distribution system without too great a loss in leakage.

On August 7, 1950, Refiners proposed to Lyman that it supply Hilo Gas with butane at 16 cents per gallon. Refiners would also provide equipment and appurtenances for butane air installation at the Hilo plant for about $25,000, to be repaid by Hilo Gas through an additional 1 cent per gallon payment for all butane used in its system. Lyman, however, in addition wished to acquire the franchise for distribution of "Isle-Gas," Refiners' trade name for butane that it distributed in tanks or containers for use by rural customers, throughout the Island of Hawaii at the price quoted for use in the Hilo Gas mains.

After extended negotiations, on October 5, 1950, the Board of Directors of Refiners authorized the purchase by it of all the stock of Hilo Gas.

The Hilo Gas stock was purchased by Refiners rather than by Honolulu Gas, because Refiners, as the distributor of butane, had the primary interest in securing the Hilo market.

On October 25, 1950, the general manager reported to the directors of Refiners that 96% of the stock of Hilo Gas had been acquired by Refiners—all but 164 shares. Refiners never acquired more than 1,872 of the 1,929 outstanding shares of the 7% preferred stock of Hilo Gas and did not acquire the last minority-owned share of the 8% preferred stock until shortly before the dissolution of Hilo Gas in 1956.

The total cost to Refiners of the Hilo Gas stock was $63,897.20.

Under Hawaiian law, no public utility may dispose of property connected with its duties without first securing from the Commission an "order" authorizing it to do so. Without such order, every such disposition of property shall be void. Section 104-18, Revised Laws of Hawaii, 1955.

On October 20, 1950, Hilo Gas filed a petition with the Commission in which it recited that it proposed to sell all its assets, except those related to the appliance sales and liquefied petroleum gas business, to Honolulu Gas for approximately $60,000. The Commission, in an order filed on November 15, 1950, authorized Hilo Gas to sell its utility assets to Honolulu Gas for $64,000.

Hawaiian law requires that the sale of substantially all of the property receive the affirmative vote of three-fourths of all stock issued and outstanding and having voting power. Section 170-30, RLH, 1955. The stockholders of Hilo Gas authorized the sale of the Company's utility assets to Honolulu Gas and the sale of the appliance and liquefied petroleum gas business and assets to Refiners. On October 31, 1950, Hilo Gas executed a bill of sale transferring to Refiners for $18,500 the assets relating to the appliance sales and liquefied gas business.

On October 31, 1950, Hilo Gas and Honolulu Gas executed an instrument whereby Hilo Gas conveyed to Honolulu Gas for $46,000 its utility manufacturing plant, etc., and Honolulu Gas assumed the liabilities of Hilo Gas. Possession of these assets was not taken by the purchasers until after October 31, 1950.

On the same day, Hilo Gas sold assets having a basis for tax purposes of $211,684.90 to Honolulu Gas and to Refiners for $88,754.32. Such consideration consisted of cash in the amount of $46,000, paid by Honolulu Gas, $18,500 in cash paid by Refiners, and assumption of liabilities amounting to $25,254.32 by Honolulu Gas. The utility assets were sold to Honolulu Gas at $122,930.58 less than their net book value, and consisted of "property used in the trade or business" as defined in Section 111(j)(1), Internal Revenue Code of 1939.

After the Public Utilities Commission approved the sale of the utility assets of Hilo Gas to Honolulu Gas, the necessary facilities for converting the Hilo system to butane air were ordered. Until April 1, 1951, all of the gas furnished to Hilo was manufactured at the old plant of Hilo Gas.

Hilo Gas had never claimed an obsolescence or abandonment loss for tax purposes on any of the utility assets sold by it to Honolulu Gas on October 31, 1950.

The utility assets sold to Honolulu Gas on October 31, 1950, and abandoned, scrapped or transferred to the Honolulu Division by Honolulu Gas after April 1, 1951, totaled $52,839.65. Utility assets, other than cash, receivables, inventories and supplies, sold to Honolulu Gas on October 31, 1950, that were continued in use in the Hilo operations of Honolulu Gas after April 1, 1951, totaled $113,-635.15.

As a result of the sale of these utility assets to Honolulu Gas for $122,930.58 less than their net book value, Hilo Gas claimed a net operating loss of $117,792.57 for 1950.

Refiners and Hilo Gas filed consolidated Federal income tax returns for 1950-53, inclusive. Refiners and Hilo Gas filed separate returns for 1954 and 1955. Both companies filed separate Territorial income tax returns for 1950-1955, inclusive.

In 1950 Refiners suffered a loss of $93,092. In 1951 it had a net income of $17,445, and in 1952, $39,147. It did not have to pay any Federal or Territorial income taxes in those years. In 1953 it had a net income before income taxes of $206,397.20 and after income taxes (as reported) of $167,229. In 1954 it has a net income before income taxes of $215,735.66, and after income taxes (as reported) of $104,977. All the foregoing figures are on an unconsolidated basis.

Hilo Gas filed annual "Corporation Exhibits" required by Territorial Law for 1950-1955. Those Exhibits showed the following:

Year	Total Income	Total Expenses	Net Income Before Taxes
1951	$19,294.16	$18,324.96	$ 969.20
1952	10,732.76	10,273.26	459.50
1953	8,600.00	5,830.71	2,769.29
1954	8,600.00	6,009.25	2,590.75
1955	8,700.00	6,063.04	2,636.96

Hilo Gas was dissolved effective September 18, 1956.

Although Hilo Gas sold to Honolulu Gas its utility assets for $46,000 and the assumption of liabilities, actually it did not sell or distribute all its assets in that year. In fact, it continued its corporate existence and activities until it was dissolved in 1956 by order of the Treasurer of the Territory of Hawaii, supra.

On October 31, 1950, Hilo Gas sold to Honolulu Gas its utility assets for $46,000 and the assumption of liabilities, supra. On the same date it transferred its merchandise and liquefied petroleum gas business to Refiners for $18,500. Hilo Gas retained certain assets in addition to the $64,500 cash received from the sale of its properties.

Refiners included the net loss from the sale in October, 1950, of the utility assets of Hilo Gas to Honolulu Gas in computing the net operating loss carry-over to subsequent years, in the consolidated income tax returns timely filed for Refiners and Hilo Gas. The Commissioner has disallowed this item, which amounted to $116,405.64, supra. In the explanation for this disallowance, the Commissioner stated:

"* * * it is held that such loss may not be included as a part of a consolidated net loss reported on a consolidated return filed by Pacific Refiners, Ltd., as a parent, and Hilo Gas Company, Ltd., as subsidiary, for the calendar year 1950 since the loss, if any, was sustained in, or was allocable to, the period prior to affiliation and before the consolidation became effective. Accordingly, the net loss, if any, sustained as the result of the sale of the utility assets of Hilo Gas Company, Ltd., to Honolulu Gas Company, Ltd., in the year 1950 may not be claimed as a part of the net operating loss deduction against the income of Pacific Refiners, Ltd., in the year 1953. The deduction claimed of $116,405.64 is, therefore, disallowed."

On June 4, 1957, the plaintiff, as Trustee for the creditors and stockholders of Refiners, paid a deficiency of $58,472.39, together with interest of $11,301.99, assessed against Refiners by the Commissioner for 1953 on account of his disallowance of the carry-over to 1953 of the net operating loss suffered by Hilo Gas in 1950 upon the sale of the utility assets to Honolulu Gas.

On August 28, 1957, the plaintiff duly filed a claim for refund for 1953, covering the payment referred to in the preceding paragraph.

On October 23, 1957, a Notice of Disallowance in full of the plaintiff's claim for refund of $69,774.38 for 1953 was mailed to the plaintiff, and no part of that sum has been refunded to the plaintiff.

On December 6, 1955, the refinery facilities of Refiners were sold to Standard, and the Isle-Gas business and assets were sold to Honolulu Gas on December 31, 1955. Refiners was dissolved by order of the Territorial Treasurer on November 19, 1956. No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas, pursuant to Section 337 of the Internal Revenue Code of 1954.

In its tax return for 1955, Refiners claimed a deduction for organization expenses of $43,163.48.

Included therein was the amount of $30,678.62, relating to expenses in connection with the issue of capital stock, $9,259.74 and $21,418.88 in 1951. The Commissioner's Appellate Division disallowed this claim, stating that "these expenses incurred in marketing your capital stock do not constitute organization expenses, but serve to reduce the proceeds derived from the sale of the stock and are properly chargeable against the paid-in capital."

In its 1955 income tax return, Refiners claimed a deduction for accrued territorial net income taxes of $67,648.77, based on the net income reportable for territorial net income tax purposes. The income included (1) the gain from the sale of Isle-Gas business and related assets to Honolulu Gas in December, 1955, and (2) the gain from the sale of refinery facilities and related assets to Standard. The Commissioner has disallowed that portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets, under the provisions of Section 265 of the Internal Revenue Code of 1954. The Commissioner stated that that Section "prohibits the deduction of expenses allocable to income exempt from federal income tax." The amount of the total Territorial net income tax of $74,408.15, allocable to these gains and disallowed by the Commissioner for Federal income tax purposes, was $61,061.59.

The Commissioner assessed a deficiency of $51,468.20, plus interest of $3,850.97, against Refiners for 1955, principally because of his disallowance of the capital stock expense—$30,678.62, supra—and his disallowance of the 1955 Territorial income taxes—$61,061.59, supra. The plaintiff paid the entire amount of that deficiency, in installments.

On August 28, 1957, the plaintiff duly filed a claim for refund with the District Director of Internal Revenue for $51,219.79, plus interest of $3,753.77, or a total of $54,973.56. On October 23, 1957, a Notice of Disallowance in full of the plaintiff's claim for the above amount was mailed to the plaintiff by the District Director. No part of the above claim for refund has been paid to the plaintiff.

3. The Plaintiff's Argument.

Hilo Gas, Refiners' subsidiary, suffered a net operating loss in 1950, which Refiners is entitled to carry forward as a consolidated net operating loss to 1953.

Under the plain terms of the statute and regulations, Refiners is entitled to include the Hilo Gas loss on the sale of its utility assets in its consolidated net operating loss for 1950, and to carry it forward as a consolidated net operating loss to 1953.

A deductible loss was sustained on the sale of utility assets by Hilo Gas to Honolulu Gas in 1950.

The Hilo Gas loss was sustained after affiliation with Refiners, not before. Hilo Gas could not have claimed an abandonment loss or an obsolescence deduction for the pre-affiliation period.

II.

The expenses of selling Refiners' capital stock are deductible in the year of liquidation.

It is established that the organization expenses of a corporation may be deducted in the year of dissolution when all assets are disposed of and nothing remains but winding up.

Capital stock costs here involved are not salesmen's commissions, but are ordinary out-of-pocket expenses—attorneys' and accountants' fees, printing expenses, and charges of the stock subscription agent. There is no rational way of distinguishing these expenses from other organization expenses, and they should be allowed as a deduction when the corporation liquidates.

III.

Territorial income taxes on capital gains realized in 1955 are deductible.

It has been stipulated that no gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas, pursuant to Section 337, Internal Revenue Code of 1954.

Section 164(a) provides that, except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Refiners is entitled to the deduction for Territorial taxes for 1955.

4. The 1950 Book Loss Suffered by Hilo Gas in the Sale of Its Assets to Refiners Is Not Available to the Latter as a "Net Operating Loss Carryover."

This Court believes that the defendant is correct in its contention that the Commissioner's action in disallowing the claimed "loss carryover" was correct.

Refiners should be denied the benefit of the Hilo Gas loss through the filing of consolidated returns, since Refiners has not established that "the principal purpose for" the acquisition of Hilo Gas was not for "evasion or avoidance of Federal income * * * tax."

Section 129 of the Internal Revenue Code of 1939 is explicit on the subject:

"(a) Disallowance of deduction, credit or allowance. If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by se-

curing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed."
(Emphasis supplied.)

Quite aside from Section 129, however, Section 141 of the Code of 1939, which extends the privilege of making consolidated returns to affiliated groups, may not be utilized to distort income by acquiring a "loss corporation" for a nominal consideration, and then using such corporation's losses to avoid taxes.

The total cost of the Hilo Gas stock to Refiners was $63,897.20. Refiners by its purchase acquired "95% or more" of the outstanding capital stock of Hilo Gas. At a hearing before the Commission on October 26, 1950, K. A. Conningham, assistant treasurer of Refiners, testified that his company had purchased approximately 95% of the capital stock of Hilo Gas from various stockholders, and that the acquisition was completed "about ten days ago."

On October 31, 1950, Hilo Gas sold assets having a basis for tax purposes of $211,684.90 to Honolulu Gas and to Refiners for $88,754.32.

The defendant argues with much force that there is here presented the question whether the acquisition for $63,897.20 of 95% of the stock of a corporation which shortly afterward was sold for assets of $88,754.32 entitles Refiners to the carryover of a $117,792.57 loss attributable to the sale of those same assets.

The officials of Refiners did not know what the book value of the Hilo Gas assets was, and the Hilo Gas books were not made available to Refiners until after the decision had been made to purchase the Lyman and Hutchinson stock.

As a matter of fact, however, Hilo Gas lost money in 1948 and 1949, and was in financial difficulty. In such a situation, it has been held that the principal purpose of the acquisition was the avoidance of Federal income taxes.

In Elko Realty Company v. Commissioner, 29 T.C. 1012, affirmed, 3 Cir., 1958, 260 F. 2d 949, 950, the Tax Court had sustained the Commissioner's determination that the principal purpose of the acquisition of the two corporations by the taxpayer was the avoidance of Federal income taxes, that the deduction of their losses from the taxpayer's income was accordingly forbidden by Section 129(a), supra, and that the two corporations were in any event not affiliates of the taxpayer privileged to join in a consolidated return under Section 141, supra, since the taxpayer's acquisition of them served no business purpose, as distinguished from a tax-reducing purpose.

In such a situation, the Court of Appeals said:

"It will be seen that the question upon which this case turns is a purely factual one, namely, whether the taxpayer acquired the two corporations in question for a bona fide business purpose or, as the Tax Court found, principally in order to reduce or avoid income taxes on its own income. The evidence is discussed and the facts are found in the opinion filed in the Tax Court by Judge Train, 29 T.C. 1012, and will not be detailed here. We need merely say that our examination of the evidence satisfies us that the findings of the Tax Court have substantial evidence to support them and cannot be held to be erroneous."

An examination of the opinion of the Tax Court in that case discloses facts similar to those at bar. Harold J. Fox was Elko Realty's vice president, executive head, and owner of about 80% of its stock. Harry Spiegel was the owner and operator of the two acquired corporations—Spiegel Apartments, Inc., and Earl Apartments, Inc.

On January 1, 1951, Fox acquired 324 shares of the common stock of Spiegel Apartments and 440 shares of the common stock of Earl Apartments. The shares in question represented the only outstanding common stock of both corporations.

The respondent Commissioner having determined that the principal purpose of the acquisition was the avoidance of income tax, the burden was on the petitioning taxpayer to prove otherwise.

The two corporations were operating at a loss at the time of their acquisition, and continued to operate at a loss. The taxpayer corporation filed consolidated returns with the Spiegel and Earl corporations for 1951, 1952, and 1953, and attempted to deduct their losses.

Commenting upon the evidence adduced to show a business purpose, the Tax Court, in 29 TC at page 1025, observed:

"As we have seen, neither Fox nor the petitioner saw any operating books of the two corporations prior to their acquisition. Nor does the record suggest that they made any effort to develop such information. Harry Spiegel was the owner and operator of the 2 corporations and, even if he had had no books and records whatsoever, it would seem reasonable to expect a prospective purchaser of his business to make at least informal inquiry of him concerning its operations. Aside from Spiegel's apparent assurance that both projects were fully occupied, the record fails to disclose that petitioner, either through Fox or otherwise, made any inquiry of Spiegel as to the financial success or lack of it of the two corporations. There is certainly no suggestion that Spiegel or anyone else for that matter actually represented to Fox or the petitioner (Elko Company) that the two corporations, or either of them, were operating at a profit.

Under the circumstances, for petitioner to expect us to give serious credence to its assertion that through Fox, a thoroughly experienced business man, it entered into the transaction in question for a bona fide business purpose requires a degree of naivete which we do not possess."

Finally, it is well settled that "Unquestionably the burden of proof is on the taxpayer to show that the commissioner's determination is invalid." Helvering vs. Taylor, 1935, 293 U.S. 507, 515, and cases there cited.

In the instant case, as we have seen, the taxpayer has fallen far short of discharging that burden.

5. Expenses Connected With the Issuance of Stock Are Not Deductible in the Year of a Corporation's Dissolution; They Cannot Constitute a Charge Upon Income.

In the tax return for 1955, Refiners claimed a deduction for "organization expenses" of $43,163.48. Included therein was $30,678.62 relating to expenses in connection with the issuance of capital stock in 1951 and 1952. The Commissioner disallowed this latter item as not constituting organization expenses.

It is hornbook law, of course, that the mere fact that an expenditure is made does not entitle the taxpayer to a deduction. Since Congress has the power to prescribe deductions, the right to such a diminution must come within some applicable provision of the statute, else it does not exist. And the provision relied upon, being a matter of legislative "grace," must be "clear." New Colonial Ice Co. vs. Helvering, 1934, 292 U.S. 435, 440.

In Corning Glass Works vs. Lucas, CA D.C., 1929, 37 F. 2d 798, 799, certiorari denied, 1930, 281 U.S. 742, the appellant entered into a contract with certain bankers, under which the latter agreed to purchase at a price of $100 per share, and accrued dividends, any part of an issue of $3,000,000 preferred stock not taken by stockholders, the bankers to receive for their services, the sum of $240,000. The appellant, on account of these payments to the bankers, sought in its income tax returns to deduct $6,000 from its gross income for 1921 and $236,000 from its gross income for 1922.

The Court quoted extensively from Simmons vs. Commissioner, 1 Cir., 1929, 33 F.2d 75, 76, where it was observed:

"While expenses for organization or for obtaining additional capital are frequent in growing and successful enterprises, we think it clear that they are not 'ordinary and necessary expenses' in the productive operations of such concerns within the meaning of the tax laws."

The District of Columbia appellate court then proceeded to analyze the expenditure in that case, saying:

"In the instant case, appellant sold to Estabrook & Co. (the bankers) preferred stock of the value of $3,000,000 at a discount of $8 per share; so that appellant received, not $3,000,000, but $2,760,000; in other words, $92 per share. The effect of this transaction was to reduce by the amount of $240,000 the capital available to appellant. In other words, it represents a <u>capital</u> expenditure, and should be charged against the proceeds of the <u>stock</u>, and not be recouped out of operating earnings. The regulations and rulings of the Treasury Department have consistently been to the effect that expenses incident to the sale of the capital stock of a corporation are not '<u>ordinary and necessary expenses incurred in carrying on the business' of such corporation.</u>" (Emphasis supplied.)

In summary, costs of marketing stock are not deductible in the year of organization; or as ordinary and necessary business expenses when incurred; and they are not deuctible in the year of dissolution. In a word, they are not deductible at any time.

The amount of $30,678.62 was properly disallowed by the Commissioner.

6. Refiners Cannot Claim a Deduction on Its 1955 Federal Income Tax Return for Territorial Income Taxes Allocable to Gain From the Sale of Its Properties. Such Gain Is Not Recognizable for Federal Tax Purposes.

In December, 1955, in accordance with a plan of complete liquidation, Refiners sold all its assets to Standard and Honolulu Gas. No gain or loss to Refiners was recognized on that sale for Federal tax purposes, pursuant to Section 337 of the Code of 1954. The total territorial income tax paid by Refiners for 1955 was $74,408.15. The Commissioner disallowed the portion of the Territorial net income tax allocable to the gain from the sale of the foregoing assets, stating that Section 265 of the Code of 1954 "prohibits the deduction of expenses allocable to income exempt from Federal income tax." The amount of the total Territorial net income tax of

$74,408.15 allocable to these gains and disallowed by the Commissioner for Federal income tax purposes, was $61,061.59.

Section 265(1) of the Code of 1954 reads as follows:

"No deduction shall be allowed for——

"(1) Expenses—Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle."

Section 1.265-1(b) of the Treasury Regulations reads as follows:

"Section 1.265-1 Expenses relating to tax exempt income.

* * *

"(b) Exempt income and nonexempt income.

"(1) As used in this section, the term 'class of exempt income' means any class of income (whether or not any amount of such class is received or accrued) wholly exempt from the taxes imposed by subtitle A of the Internal Revenue Code of 1954. For the purposes of this section, a class of income which is considered as wholly exempt from the taxes imposed by subtitle A includes any class of income which is——

"(i) Wholly excluded from gross income under any provision of subtitle A, or

"(ii) Wholly exempt from the taxes imposed by subtitle A under the provisions of any other law.

"(2) As used in this section the term 'non-exempt income' means any income which is required to be included in gross income."

From the foregoing, it is apparent that there are only two classes of income involved; taxable income and exempt income, the latter being defined as that which is not required to be included in gross income.

As we have seen, it is agreed that "No gain or loss to Refiners was recognized on the sale of its assets to Standard and Honolulu Gas," under the provisions of Section 337 of the Code of 1954. Accordingly, it must qualify as exempt income. Since the gain is not included in Refiners' income, it follows that there is no basis for allowing a deduction for the expenses—that is to say, the Territorial tax—related to such income.

This Court cannot go along with counsel's effort to escape this logic.

Without laboring the point further, the Court holds that the Commissioner correctly disallowed the claimed deduction for Territorial taxes paid, since they relate to an income-source of Refiners that is exempt from tax under Section 265(1) and the applicable Treasury Regulations, supra.

7. Conclusion.

In summary, the Commissioner's disallowance of the loss on the sale of the Hilo Gas assets and his disallowance of the claimed deductions for organization expenses and Territorial tax, were correct.

Accordingly, this Court concludes that the plaintiff should take nothing by its Complaint, and that the defendant should have its costs. It is, therefore,

Ordered, that the defendant have judgment against the plaintiff, together with its costs in this action incurred.

Counsel for defendant is directed to prepare and lodge with the Court findings of fact and conclusions of law, and form of judgment which when adopted and filed will constitute the findings, conclusions and judgment of this Court.

Dated at Las Vegas, Nevada, this 18th day of November, 1959.

/s/ JOHN R. ROSS,
United States District Judge.

[Endorsed]: Filed November 24, 1959.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This is an action brought by plaintiff as Trustee for the creditors and stockholders of Pacific Refiners, Limited, a dissolved Hawaiian corporation to recover $109,692.18, representing deficiency income taxes for the calendar years 1953 and 1955 and $15,055.76 interest on said deficiency, which was assessed against and collected from plaintiff, together with interest thereon as provided by law.

This action having come on regularly for trial before the Honorable John R. Ross, United States District Court Judge, sitting without a Jury, plaintiff appearing by Marshall M. Goodsill, its attorney of record and the defendant appearing by Louis B. Blissard, United States Attorney for the District of Hawaii, its attorney of record; and all of the facts and exhibits in this action having been fully stipulated, and the court after considering all of the evidence set forth in the stipulation of facts and the contentions of each respective party, and having given due weight to the arguments set forth in the briefs of the respective parties, hereby makes and enters its

Findings of Fact

1. The findings of fact are as set forth in the "Stipulation of Facts," pages 3 through 11 in the

Opinion and Judgment filed herein on November 24, 1959.

Conclusions of Law

1. This Court has jurisdiction of the subject matter and of the parties hereto.

2. Plaintiff has not sustained its burden of proof that the Commissioner erred in refusing to permit Refiners to carry over the adjusted loss sustained by Hilo in 1950 as a net operating loss carryover in the consolidated income tax return filed by Refiners for the year 1953.

3. Refiners is not entitled to the benefit of the loss sustained by Hilo in 1950 as a carryover net operating loss in determining its consolidated net taxable income for the year 1953, since Refiners has not established that the principal purpose for the acquisition of Hilo was not for the evasion or avoidance of federal income tax, as required by Section 129 of the Internal Revenue Code of 1939.

4. The cost of marketing Refiners' capital stock is not deductible as an ordinary and necessary expense either in the year of organization or during the year the expenditures were incurred or in the year of dissolution of Refiners, and therefore the Commissioner correctly and properly disallowed the sum of $30,678.62, representing the cost of marketing Refiners' capital stock included in the organization expense claimed as a deduction for the year 1955, in determining its net taxable income for that year.

5. Under the provisions of Section 265(1) of the Internal Revenue Code of 1954, no deduction is allowable for any amount otherwise allowable as a deduction, which is allocable to one or more classes of income wholly exempt from taxes imposed by Sub-title A of the 1954 Code. Since no gain or loss to Refiners was recognized on the sale of its assets in 1955 to Standard Oil Company and Honolulu Gas under the provisions of Section 337 of the Internal Revenue Code of 1954, this nontaxable gain qualifies as exempt income under Section 265(1) of the 1954 Code, and therefore Refiners is not entitled to the claimed deduction of $61,061.59 for the year 1955 in determining its net taxable income for that year.

6. Plaintiff is entitled to take nothing by this action and judgment should therefore be entered for the defendant on the merits, dismissing the action with prejudice, the defendant to recover its costs, if any, from plaintiff.

/s/ JOHN R. ROSS,
United States District Judge.

Dated: February 26, 1960.

Approved as to Form:

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

[Endorsed]: Filed March 4, 1960.

In the United States District Court
For the District of Hawaii

Civil No. 1619

HAWAIIAN TRUST COMPANY, LIMITED, a Hawaii Corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a Dissolved Hawaii Corporation,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant,

JUDGMENT ORDER

The above-entitled cause having come on regularly for trial before this Court, the Honorable John R. Ross, United States District Court Judge, presiding therein, sitting without a jury, plaintiff and the defendant appearing by their respective attorneys, and all of the facts having been stipulated by written stipulation filed herein between the parties, and briefs having been filed by and in behalf of the respective parties, and the Court, having duly considered the same and having rendered its Opinion and made and entered its Findings of Fact and Conclusions of Law;

It is therefore, Ordered, Adjudged and Decreed that plaintiff is not entitled to any recovery prayed for in the Complaint and that judgment is hereby entered dismissing the complaint with costs, if any, to be assessed against plaintiff.

/s/ JOHN R. ROSS,
District Judge.

Entered February 26, 1960.

Approved as to Form:

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff.

[Endorsed]: Filed and entered March 4, 1960.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Hawaiian Trust Company, Limited, a Hawaii corporation, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, a dissolved Hawaii corporation, plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action.

Bond for Costs on Appeal in this action was filed with this court on January 21, 1960.

Dated: Honolulu, Hawaii, March 11, 1960.

/s/ MARSHALL M. GOODSILL,
Attorney for Appellant, Hawaiian Trust Company, Ltd.

Receipt of copy acknowledged.

[Endorsed]: Filed March 11, 1960.

[Title of District Court and Cause.]

STATEMENT OF POINTS ON APPEAL

Pursuant to Rule 75(d) of the Federal Rules of Civil Procedure, Hawaiian Trust Company, Limited, plaintiff-appellant in this action, states that the following are the points upon which plaintiff-appellant will rely on appeal:

1. The United States District Court for the District of Hawaii erred in concluding that plaintiff is not entitled to any recovery prayed for in its complaint and in dismissing the complaint in this action.

2. Hilo Gas Company, Limited, suffered a net operating loss in 1950 which Pacific Refiners, Limited, was entitled to carry forward as a consolidated net operating loss to 1953.

3. Pacific Refiners, Limited, was entitled to deduct in 1955 Hawaii income taxes allocable to capital gains realized in 1955 but not recognized for federal income tax purposes by reason of Section 337, Internal Revenue Code 1954.

Dated: Honolulu, Hawaii, March 11, 1960.

/s/ MARSHALL M. GOODSILL,
Attorney for Plaintiff-Appellant, Hawaiian Trust Company, Limited.

Service of copy acknowledged.

[Endorsed]: Filed March 11, 1960.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Hawaii—ss.

I, William F. Thompson, Jr., Clerk of the United States District Court for the District of Hawaii, do hereby certify that the foregoing record on appeal in the above-entitled cause, numbered from Page 1 to Page 126 consists of a statement of the names and addresses of the attorneys of record and of the various original pleadings as hereinbelow listed and indicated:

Complaint and Summons.
Answer.
Stipulation of Facts.
Stipulation With Respect to Questions of Law.
Opinion and Judgment.
Findings of Fact and Conclusions of Law.
Judgment Order.
Notice of Appeal.
Statement of Points on Appeal.
Bond for Costs on Appeal.
Designation of Contents of Record on Appeal.
Counter-Designation of Record on Appeal.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court, this 24th day of March, 1960.

[Seal] /s/ WM. F. THOMPSON, JR.,
Clerk.

[Endorsed]: No. 16859. United States Court of Appeals for the Ninth Circuit. Hawaiian Trust Company, Limited, Trustee for the Creditors and Stockholders of Pacific Refiners, Limited, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Hawaii.

Filed March 31, 1960.

Docketed: April 12, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.